

**REGULATORY REFORM OF  
THE KOREAN COMPETITION LAW AND  
POLICY ON VERTICAL RESTRAINTS**

*A Critical Analysis of Competition Law on Vertical Restraints in  
The Republic of Korea, with Reference to  
The US, the EC, and Japan*

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## ABSTRACT

‘You shall not follow a crowd to do evil; nor shall you testify in a dispute so as to turn aside after many to pervert justice. You shall not show partiality to a poor man in his dispute.’  
(NKJV: Exodus 23: 2-3)

This thesis is concerned with the question of whether the Korean competition authority is well prepared for the open market with regard to vertical restraints. This further brings some issues such as of whether the authority partially scrutinises enterprises without proper evidences based on economics. This question has come from the following, ‘what is the fundamental matter in competition laws of Asian developing countries which have different economic development backgrounds than western developed countries?’ This subject has brought a question, even now, to the point the relationship between macroeconomic and microeconomic policies in the middle of competition law. Most of competition scholars focus on microeconomic way of competition law and policy but, in fact, it often seems that macroeconomic concerns have influenced competition laws in developing countries such as the Republic of Korea.

Because the Korean economy is still fledging and experiencing further challenges for development, the Korean competition law should be more experimented in order to adjust to the rapid changes in global economy. This task should be done in both macro- and microeconomic levels and also a critical analysis of competition law of the Republic of Korea with reference to the US and the EC since these regimes have diverse legal techniques. Furthermore, since the Korean competition law was heavily influenced by the Japanese antimonopoly law, a comparative study of the Japanese law is necessary. This thesis aims to develop the Korean competition law on vertical restraints through a critical assessment by economics and comparative studies. This is, therefore, the first means for testing concerning vertical regulation that is probably still controversial in the Korean market. Lastly, translations of titles, authors, and publishers from the Korean works are unofficial, and the laws in this thesis are up to date at May 2009.

# TABLE OF CONTENTS

<i>Table of Cases</i>	vii
<i>Table of Legislations</i>	xv
<i>Acknowledgements</i>	xix
<i>Author's Declaration</i>	xx
<i>List of Abbreviations</i>	xxi
<b>Chapter 1. Introduction</b>	<b>1</b>
1.1. Global and Comparative Perspectives in Competition Policy on Vertical Relations	1
1.2. Korean Brand Competition Law, Economic Growth and International Trade	4
1.3. Research Questions and Structure of Thesis	7
<b>Chapter 2. Historical Development of Korean Economy and Competition Law</b>	<b>12</b>
2.1. Korean Economic Policy of Rapid Economic Growth and Its Costs	12
2.2. Historical Context of Competition Law Development	16
2.2.1. <i>Chaebol</i> and Problems of Market Concentration: Comparative Perspective	16
2.2.2. Establishment of Korean Competition Policy	19
2.2.3. Modification of Policies through Financial Crisis: Competition Law Experiment	22
2.3. Framework of Korean Competition Law and Policy	26
2.3.1. General Features of Korean Competition Law	26
2.3.2. Purposes of Korean Competition Law and Comparative Outlook	31
2.3.3. Arguments for Modernisation	35
2.4. Problems of Vertical Restraints: Market Power and Trade Barriers in Korea and Japan	37
2.4.1. Foreclosure of Vertical Restraint as Private Trade Barrier	37
2.4.2. Global Aspects of Korean Competition Law	38
2.5. Concluding Remarks	42
<b>Chapter 3. Economics and Comparative Competition Laws of Vertical Restraints</b>	<b>45</b>
3.1. Fundamental Issues in Vertical Relations	45
3.2. Arguments in Economic Theories of Vertical Relations	48

3.2.1. Chicago School vs. Harvard School in Theory Debates	48
3.2.2. Economics-Theoretical Approaches to the Korean Market	52
3.2.3. Theoretical Debates of Vertical Foreclosure in Korea	53
3.3. Comparative Study: Development of Competition Laws in the US and the EU	57
3.3.1. The United States	57
3.3.2. The European Union	61
3.4. Substantive Korean Competition Law	66
3.4.1. Prohibition of Abuse of Dominant Position: Chapter 2 of the MRFTA	66
3.4.2. Unfair Horizontal Concerted Acts: Chapters 4 and 6 of the MRFTA	69
3.4.3. Vertical Restraints: Chapters 5 and 7 of the MRFTA	70
3.4.3.1. Prohibitions of Unfair Business Practices	70
3.4.3.2. Prohibitions of Resale Price Maintenance	75
3.5. Concluding Remarks	76
<b>Chapter 4. Critical Review of Korean Case Law: Competition Policy Ramification</b>	78
4.1. Overview	78
4.2. Refusal to Deal	79
4.2.1. Establishment of Relevant Provisions and Problems	79
4.2.2. Critical Assessment of Current Application of Article 23 MRFTA: <i>Coca-Cola</i>	81
4.2.3. Critical Assessment of Current Application of Article 3-2 MRFTA: <i>POSCO</i>	84
4.3. Tie-in Sales	87
4.3.1. Critical Assessment of Current Application of Article 23 MRFTA: <i>Korea Land</i>	87
4.3.2. Critical Assessment of Current Application of Article 3-2 MRFTA: <i>Microsoft</i>	89
4.3.3. Critical Assessments in Ti-in Sale Cases from Economic Debates	92
4.4. Exclusive Dealing and Territorial Restriction	94
4.4.1. Transaction Based upon Restrictive Conditions under Article 23 MRFTA	94
4.4.2. Exclusive Dealing as Transaction of Restrictive Condition: <i>Korean Air Lines</i>	96
4.4.3. Territorial Restriction as Transaction of Restrictive Condition: <i>Domino Pizza</i>	99
4.4.4. Critical Assessments in Restrictive Condition Cases from Economic Debates	101
4.5. Resale Price Maintenance	103
4.5.1. Critical Assessment of Current Application of Article 29 MRFTA: <i>Dairy Cases</i>	103
4.5.2. Critical Assessments in RPM Cases from Economic Debates	107
4.6. Trade-Off and Balance Tests in the Korean Case Law	109



4.6.1. Fairness and Pro-competitiveness: Market Foreclosure vs. Efficiency	109
4.6.2. Critical Argument of Case Law Development in Rule of Reason and Per Se Rule	113
4.7. Concluding Remarks	116
<b>Chapter 5. Critical Analysis of Competition Law on Vertical Restraints</b>	117
5.1. Demands for Vertical Regulation Reform	117
5.2. Purposes of Korean Vertical Regulation Revisited	120
5.2.1. Total Welfare from Vertical Restraints	120
5.2.2. Economic Growth and International Trade Improvement from Vertical Restraints	122
5.2.3. Pursuit of Better Vertical Regulation for Purposes of Competition Law Achievement	124
5.3. Harmonising Purposes of Competition Law on Vertical Restraints: Practical Matters	126
5.3.1. More Efficiency, More Gains	126
5.3.2. Criteria for Trade-Off Test	128
5.4. Market Power in Korea: Special Responsibility vs. Efficiency in Korean Vertical Cases	130
5.4.1. Problems of Market Power and Competition in Vertical Level	130
5.4.2. Pressure of Competitive Rivalry in Vertical Relations: <i>Ex Ante</i> Approach	131
5.4.3. Consideration for Global Standard: More Economic Notes	135
5.5. Statutory Problems in Korean Competition Law and Policy on Vertical Restraints	137
5.5.1. Overview of Problems in Substantive Statutes	137
5.5.2. Double Standard on Vertical Restraints: Article 3-2 or 23 of the MRFTA?	138
5.5.2.1. Comparison between Articles 3-2 and 23 of the MRFTA	138
5.5.2.2. Origin of Double Standard: Special Provision and General Provision	141
5.5.2.3. Presumption of Market Dominance: Unclear Statement Creates Uncertainty	142
5.5.3. Implementation of UBP Guidelines in Theory and Practice	144
5.5.4. Justifications for Inter-brand Competition in RPM: Per Se or Rule of Reason?	146
5.6. Concluding Remarks	148
<b>Chapter 6. Modernisation of Korean Vertical Regulation:</b>	
<b>Proposals for New Legislation and Future Implications</b>	151
6.1. Creation of the New Korean Type Vertical Regulation from Comparative Study	151
6.2. Amendment to Provisions of Abuse of Market Dominance	153
6.2.1. Amendment to Article 4 MRFTA and Market Dominance Guidelines	153
6.2.2. Market Share Threshold and Other Criteria of Presumption Suggested	157

6.2.3. Presumption of Anti-Competitiveness or Unfairness: Economic Approach	160
6.3. Amendment to Provision of UBP: Article 23 MRFTA and UBP Guidelines	164
6.3.1. Articles 19 and 23 MRFTA: Single Provision for Agreement Cases	164
6.3.2. Presumption of Efficiency in Vertical Restraints and Exemption Provisions	166
6.4. Amendment to Provision of RPM: Article 29 MRFTA and RPM Guidelines	169
6.4.1. Withdrawal of Article 29 MRFTA	169
6.5. Modernisation: Establishment of Korean Vertical Guidelines	172
6.5.1. Withdrawal of Per Se Provision with Caution	172
6.5.2. One-Fits-All Approach: New Safe Harbour and Pursuit of Legal Certainty	174
6.5.3. Supplementary Factors Considered for New Guidelines: Inter-brand Competition	179
6.6. Concluding Remarks	181
<b>Chapter 7. Critical Assessment of Regulatory Reform: Model for Globalisation</b>	183
7.1. New Vertical Regulation Approach Scrutinised for Small Market	183
7.2. Micro-Assessments on the New Vertical Regulation	188
7.2.1. Provisions on Abuse of Market Dominant Position	188
7.2.2. Provisions on Unfair Concerted Agreements: Market Share Threshold	192
7.3. Macro-Assessments: International Trade, Market Access, and the New Regulation	196
7.3.1. Mutual Interaction and Problems in Strategic Competition Law Legislation	196
7.3.2. Choice of Vertical Regulation Enforcement: Case of Japan	199
7.4. Final Thought from Modernisation	203
7.4.1. Competition Policy Design from Economics: the Age of Efficiency	203
7.4.2. Vertical Regulation Reform for Clarifying Objectives of Competition Policy	204
7.5. Concluding Remarks	209
<b>Chapter 8. Conclusion</b>	211
<i>Appendix. Substantive Legislations (Excerpts)</i>	219
<i>Glossary</i>	237
<i>Bibliography</i>	243

# TABLE OF CASES

## *THE REPUBLIC OF KOREA*

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- Dongwon Co.*, KFTC Decision 92-81, 9203Dok082, July 1, 1992 --- 112
- OBC Gram Corp.*, KFTC Decision 92-124, 9209Il438, Oct. 22, 1992 --- 88
- Pusan Dairy Association*, KFTC Decision 93-61, 930Il262, June 30, 1993 --- 112
- Dongyang Beer Co.*, KFTC Decision 93106, 9306Dok343, July 22, 1993 --- 94
- Hanil Co.*, KFTC Decision 94-196, 9405Kusa326, July 14, 1994 --- 80
- Korea Electricity Corp.*, KFTC Decision 95-15, Apr. 4, 1995 --- 68
- Charmzone Cosmetics Co.*, KFTC Decision 95-292, 9508Kyoungjung743, Dec. 5, 1995---111
- Daeha Fashion Corp.*, KFTC Decision 96-193, 9607Choi1105, Aug. 21, 1996 --- 75, 77
- Dongyang Nylon Co. Ltd*, KFTC Decision 96-51, Apr. 22, 1996 --- 123
- Carrefour Korea Co.*, KFTC Decision 97-51, Feb. 26, 1997 --- 88
- Coca-Cola Korea Co.*, KFTC Decision 97-133, 9704Kyungchok0614, Aug. 27, 1997 --- 81, 82, 161
- Korea Tobacco and Ginseng Co., Ltd*, KFTC Decision 98-51, Mar. 11, 1998 --- 94
- Namyang Co.*, KFTC Decision 98-112, 9804Dokkwan0559, June 9, 1998 --- 77
- Bohae Distrilling Co.*, KFTC Decision 98-125, June 29, 1998 --- 144
- POSTEEL and POSCO*, KFTC Decision 98-272, Nov. 25, 1998 --- 144
- Korean Air Lines Co., Ltd*, KFTC Decision 2000-79, 2000YuGoe0018, May 25, 2000 --- 96-99, 101
- DPK International Co., Ltd*, KFTC Decision 2000-163, 2000Yugo0069, Nov. 15, 2000 --- 99, 112
- Morning Glory Co.*, KFTC Decision 2002-163, 2000Yugo0069, Nov. 15, 2000 --- 99
- Youngil Chemical Corp.*, KFTC Decision 2001-22, 2000Kyoungchok0929, Jan. 11, 2001---84
- POSCO*, KFTC Decision 2001-068, 2001Kyoungchok0389, Apr. 12, 2001 --- 84, 111, 140
- Korea Electricity Corp.*, KFTC Decision 2001-043, 2001Dokjom0265, Mar. 31, 2001 --- 140

*SK Inc./Deahan Refinery Corp.*, KFTC Decision 2001-090, 2001*Kikyoul*1398, June 29, 2001 --- 110

*Shinsegi Communications Corp.*, KFTC Decision 2001-123, 2001*Dokjom*1510, Aug. 23, 2001 --- 96

*SK Telecom Corp.*, KFTC Decision 2001-127, 2001*Dokjom*1507, Sept. 10, 2001 --- 89

*SK Telecom Corp.*, KFTC Decision 2001-183, 2001*Kyoungchok*1955, Oct. 8, 2001 --- 135

*Hanaro Communications Corp.*, KFTC Decision 2002-001, 2001*Dokjom*2656, Jan. 5, 2002 -- 96

*Thrunet Corp.*, KFTC Decision 2002-002, 2001*Dokjom*2658, Jan. 5, 2002 --- 96

*Seven Banks refusal to deal against Samsung Card Co.*, KFTC Decision 2002-001, 2001*Dokjom*2503, Jan. 8, 2002 --- 80

*Kangwon Land Corp.*, KFTC Decision 2002-038, 2001*Dokwan*1673, Jan. 17, 2002 --- 98

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*Hyundai Motors-Kia Motors/Wia Corp.* KFTC Decision 2002-111, 2002*Kikyoul*0610, June 18, 2002 --- 128

*Samsonite Korea Corp.*, KFTC Decision 2002-213, 2002*Yugo*1369, Dec. 23, 2002 --- 147

*DuPont Korea*, KFTC Decision 2002-363, 2002*Kyoungchok*0588, Dec. 23, 2002 --- 84, 140

*Taepyeongyang Cosmetics*, KFTC Decision 2002-366, 2002*Danchae*1702, Dec. 24, 2002 --- 174

*LG Health Corp.*, KFTC Decision 2002-367, 2002*Danchae*1696, Dec. 24, 2002 --- 147, 172

*L'Oreal Korea*, KFTC Decision 2002-368, 2002*Danchae*1700, Dec. 24, 2002 --- 147, 172

*Four Department Stores*, KFTC Decision 2002-340, 2002*Yougo*1083, Nov. 28, 2002 --- 80

*Eight Cosmetics companies*, KFTC Decision 2002-369, 2002*Danchae*1701, Dec. 24, 2002 --- 80

*Aekyoung Cosmetics*, KFTC Decision 2003-002, 2002*Danchae*1699, Jan. 6, 2003 --- 147

*Koreana Cosmetics*, KFTC Decision 2003-003, 2002*Danchae*1697, Jan. 6, 2003 --- 147

*Hankuk Cosmetics*, KFTC Decision 2003-004, 2202*Danchae*1698, Jan. 6, 2003 --- 147

*Yongsan Chemical Co. Ltd/Korea PTG Co.*, KFTC Decision 2003-154, Sept. 24, 2003 --- 123

*Renault-Samsung Motors*, KFTC Decision 2004-017, 2003*Choi*3739, Jan. 19, 2004 --- 104

*Nomshim Corp.*, KFTC Decision 2004-036, 2003*Danchae*2188, Feb. 11, 2004 --- 174

*Haitai Corp.*, KFTC Decision 2004-041, 2003*Danchae*2189, Feb. 11, 2004 --- 174

*Lotte Chilsung Corp.*, KFTC Decision 2004-039, 2003*Danchae*2190, Feb. 11, 2004 --- 174

*Woongjin Food Corp.*, KFTC Decision 2004-185, 2003*Kyoungchok*0423, 0424, 0550, June 7,

2004 --- 174

*Pusan and Kyounghnam Liquor Associations, Hite Co., and Daesun Distilling Co.*, KFTC Decision 2004-238, 2004Busa0093, 2004Busa1025-27, July 31, 2004 --- 140

*Daeho Corp.*, KFTC Decision 2005-168, 2005Jonsa0500, Sept. 6, 2005 --- 174

*Johnsons Korea Corp.*, KFTC Decision 2005-180, 2005Gamaeng1066, Sept. 26, 2005 --- 102

*KGC Corp.*, KFTC Decision 2005-182, 2005Teukbo0320, Sept. 26, 2005 --- 108

*Chongkeundang Corp.*, KFTC Decision 2005-183, 2005Teukbo0533, Sept. 26, 2005 --- 108

*Namyang Aloe Corp.*, KFTC Decision 2005-184, 2005Teukbo0532, Sept. 26, 2005 --- 147

*Hewlett-Packard Korea*, KFTC Decision 2005-160, 2005Jaedo0452, Oct. 25, 2005 --- 169

*Hite Beer Corp./Jinro Corp.*, KFTC Decision 2006-009, 2005Kikyoul1484 and 2005Kikyoul2725, Jan. 24, 2006 --- 128

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*Epson Korea Corp.*, KFTC Decision 2005-163, 2005Jaedo0454, Oct. 31, 2005 --- 169

*Amore Pacific Corp.*, KFTC Decision 2006-269, 2006Sokyoung0387, Nov. 28, 2006 --- 147

*Decori Corp.*, KFTC Decision 2006-436, 2006Sokyoung0733, Dec. 18, 2006 --- 174

*Ildong Corp.*, KFTC Decision 2006-439, 2006Sokyoung2008, Dec. 18, 2006 --- 100

*SK Telecom Corp.*, KFTC Decision 2007-044, 2006Sokyoung0785, Feb. 6, 2007 --- 89, 135

*Hyundai Motors*, KFTC Decision 2007-281, 2006Dokgam0746, May 18, 2007 --- 99, 143, 154

*Wedding Blanc*, KFTC Decision 2007-057, 2006Busa1966, May 26, 2007 --- 94

*Biontech Corp.*, KFTC Decision 2007-127, 2006Sokyoung2748, May 17, 2007 --- 174

*POSCO/POSCOA*, KFTC Decision 2007-351, 2007Kyoulhap1076, July 3, 2007 --- 56

*Namyang Diary and Mael Diary*, KFTC Decision 2007-345, 2006Dokgam4792 and 4818, July 3, 2007 --- 189

*Mercedes Benz Korea Corp.*, KFTC Decision 2007-164, 2006Sokyoung2420, July 6, 2007 --- 147

*Interpark G Market Corp.*, KFTC Decision 2007-555, 2006Sokyoung4846, Dec. 18, 2007 --- 95, 143, 154, 157, 189

*Woongjin Kitchen Corp.*, KFTC Decision 2008-216, 2007Sokyoung2398, May 20, 2008 --- 174

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*Intel Corp., Intel Semiconductor Ltd, and Intel Korea*, KFTC Decision 2008-295, 2007Dokgam1790 and 2008Sijang1126, Nov. 5, 2008 --- 8, 102, 132, 188, 205  
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*Namyang Dairy Products Co. v. KFTC*, Seoul High Court 99Nu13, Oct. 7, 1999 --- 105  
*Maeil Dairy Industry Ltd v. KFTC*, Seoul High Court 98Nu14947, Jan. 28, 2000 --- 105  
*SKC Co. Ltd v. KFTC*, Seoul High Court 2000Nu1494, Jan. 30, 2001 --- 83  
*POSCO v. KFTC*, Seoul High Court 2001Nu5370, Aug. 27, 2001 --- 84  
*Lotteria Co. Ltd v. KFTC*, Seoul High Court 2000Nu2183, Dec. 4, 2001 --- 113  
*Korea Land Corp. v. KFTC*, Seoul High Court 2001Nu16288, Feb., 2004 --- 88, 89  
*Seragem Medical Device Corp. v. KFTC*, Seoul High Court 2003Nu7455, Mar. 31, 2004 --- 195  
*Muhak and Daesun Distilling v. KFTC*, Seoul High Court 2003Nu2252, Oct. 27, 2004 --- 95  
*DuPont Korea v. KFTC*, Seoul High Court 2003Nu11059, Nov. 25, 2004 --- 83  
*Hite Beer Co. v. KFTC*, Seoul High Court 2002Du11059, July 9, 2004 --- 83

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*Coca-Cola Korea Co. v. KFTC*, Supreme Court 98Du17869, Jan. 5, 2001 --- 74, 80, 83  
*SKC Co. Ltd v. KFTC*, Supreme Court 2001Du1628, Jun. 12, 2001 --- 83, 161  
*Namyang Dairy Products Co. v. KFTC*, Supreme Court 99Du11141, Dec. 24, 2001 --- 105, 178, 179  
*Dong-Suh Food, Inc. and Nestlé Korea Inc. v. KFTC*, Supreme Court 2000Du3184, May 2, 2002 --- 178

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*Hyundai Information Technology Corp. v. KFTC*, Supreme Court 99Du4686, June 12, 2001 -- 161

*Korean Medical Association v. KFTC*, Supreme Court 2001Du5347, Feb. 20, 2003 --- 27, 205

*Korea Land Corp. v. KFTC*, Supreme Court 2004Du3014, Mar. 24, 2004 --- 88

*Daewoo v. KFTC*, Supreme Court 2001Du2935, Oct. 14, 2004 --- 27

*DuPont Korea v. KFTC*, Supreme Court 2005Du746, May 27, 2005 --- 83

*Hite Beer Co. v. KFTC*, Supreme Court 2005Du746, May 27, 2005 --- 83

*Lotteria Ltd v KFTC*, Supreme Court 2002Du332, Mar. 10, 2006 --- 79, 113

*POSCO v KFTC*, Supreme Court 2002Du8626, Nov. 22, 2007 --- 27, 67, 84, 163, 191, 206

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*United States v. American Tobacco Co.*, 221 US 106, 31 S.Ct. 632 (1911) --- 155

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*United States v. Aluminium Company of America, et al.*, 148 F. 2d 416 (1945) --- 67

*United States v. Paramount Pictures Inc.* 335 U.S. 131 (1948) --- 54

*United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 76 S.Ct., 1264 (1956) --- 155

*United States v Parke, Davis & Co.*, 362 U.S. 29 (1960) --- 57, 105, 106

*Atlantic Ref. Co. v. FTC*, 381 U.S. 357, 370, 375-376 (1965) --- 87

*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1249 (1967) --- 100

*FTC v. Texaco*, 393 U.S. 223, 228-229 (1968) --- 87

*Albrecht v. Herald Co.*, 390 U.S. 145 (1968) --- 58, 109

*Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971) --- 114

*Continental T.V. v. GTE Sylvania*, 433 U.S. 36 (1977) --- 59, 100, 173

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*Aspen Skiing v. Aspen Highlands Skiing*, 472 U.S. 585 (1985) --- 67

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*Spectrum Sports Inc. v. McQuillan*, 506 U.S. 445 (1993) --- 160

*State Oil v. Khan*, 188 S. Ct. 145 (1997) --- 58, 109

*Zschaler v. Claneil Enters. Inc.*, 958 F. Supp. 929 (D. Vt. 1997) --- 176

*California Dental Association v. FTC*, 526 U.S. (1999) --- 59

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*United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d at 387 (D. Del. 2003), *rev'd*, 399 F.3d 181 (3d Cir. 2005), *cert. denied*, 126 S.Ct. 1023 (2006) --- 98

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Case 322/81 *NV Nederlandsche Baden-Industrie Michelin v. Commission* [1983] ECR 3461 - -- 86, 155

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*Yamaha* (IP/03/1028), 16 July 2003 --- 169

*Microsoft* (COMP/C-3/37.792), 24 Mar. 2004 --- 142

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*Intel Corp.* (IP/09/745), 13 May 2009 --- 205

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*Fujiki v. Shiseido*, Tokyo High Court, Sept. 5, 1993, *Hanrei Jiho*, 1474 --- 105

*Toppan Mua K.K. v. JFTC*, Tokyo High Court, Dec. 14, 1993, 840 *Hanreitimes* 81 --- 70, 165

*Shiseido Co., Ltd.*, JFTC consent Decision, Nov. 30, 1995, *Shinketushu* 42-97 --- 178

*Lawson Inc.*, JFTC Decision, July 30, 1998, *Shinketushu* 45-136 --- 73

*Microsoft Japan*, JFTC Decision, Dec. 14, 1998, *Shinketushu* 45-153 --- 92, 205

*Shiseido Co., Ltd.*, Supreme Court of Japan, Dec. 14, 1998, *Saiko Saibansho Minji Hanreishu (Minshu)* 52-9-1866 --- 147

*Panasonic*, JFTC Decision, July 27, 2001, *Shinketushu* 48-187 --- 104

*Mitsubishi Building Techno*, JFTC Decision, July 26, 2002, *Shinketushu* 49-168 --- 104

*Uny Co. Ltd.*, JFTC Decision, Jan. 7, 2005, *Shinketushu* 51-543 --- 73

*Intel K.K.*, JFTC Decision, Apr. 13, 2005, *Shinketushu* 52-341 --- 133

# TABLE OF LEGISLATIONS

## *THE REPUBLIC OF KOREA*

Constitution of the Republic of Korea

Art. 10 --- 29

Art. 15 --- 29

Art. 23 --- 29

Art. 32 --- 34

Art. 119 --- 29, 119, 120, 145

Art. 123 --- 34

Art. 124 --- 34

Art. 125 --- 34

Art. 127 --- 29, 34

Fair Franchise Transactions Act, amended by the law No. 8630, Aug. 3, 2007 --- 112

Price Stabilisation and Fair Trade Act, law No. 2798, Dec. 31, 1975 --- 20, 137

The Guidelines for review unfair business practice, established rule No. 26 of the KFTC  
amended on Mar. 11, 2005

Sec. III.1.A.(3) --- 69

Sec. III.1.A.(4) --- 141

Sec. III.2. --- 73

Sec. V.1. --- 83

Sec. V.1.A.(2) --- 80

Sec. V.1.B. --- 81

Sec. V.5.A.(1) --- 87

Sec. V.5.A.(1)(A) --- 135

Sec. V.5.A.(2) --- 95

Sec. V.5.B. --- 95

Sec.V.7.A.(2)(C) --- 145

Sec. V.7.B.(4) --- 95

The Guidelines for review resale price maintenance, KFTC established rule No. 34 enacted on Aug. 30, 2006 --- 75

Sec. 3.B.(2) --- 104

The Guidelines for review abuse of market-dominant enterprises, KFTC Notification No. 2002-6 of the KFTC amended on May 16, 2002 --- 69, 143

The Guidelines for review cartel, amended on Dec. 21, 2007

Sec. III.2 --- 194, 216

Sec. III.4 --- 194

The Guidelines for review M&A, amended by KFTC notification No. 2007-12, Dec. 20, 2007

Sec. II.1.(5)(A) --- 168

Sec. VIII.1 --- 137

Category of RPM Literary Works of KFTC Guidelines No. 2002-15, Dec. 2002 --- 75

Notification on the Types of and Criteria for Special Unfair Business Practices Relating to Large Retail Store Business, KFTC Notification No. 2001-9 amended on July 6, 2001 --- 72

Notification of Types of and Criteria for Unfair Business Practices and Abuse of Market-Dominant Position Relating to Newspaper Business, KFTC Notification No. 2003-3 amended on May 27, 2003 --- 72

## ***THE UNITED STATES***

### Sherman Act

Sec. 1 --- 57, 98, 106, 146

Sec. 2 --- 57, 91, 98, 146

### Clayton Act

Sec. 3 --- 57

### Federal Trade Commission Act

Sec. 5 --- 57, 91, 139, 162

The Miller-Tydings Act of 1937, 50 Stat. 693 --- 169

The Consumer Goods Pricing Act of 1975, 89 Stat. 801 --- 170

## ***THE EUROPEAN UNION***

### EC Treaty

Art. 2 --- 61

Art. 3 --- 61

Art. 81 --- 62-66, 164, 166, 191

Art. 82 --- 67, 90, 155, 164, 191, 192

Regulation 2790/99 OJ L336/21 on the application of Article 81(3) of the Treaty to categories of vertical agreements --- 61-64, 66, 156, 175, 191, 193

Guidelines on Vertical Restraints [2000] OJ C 291/01, [2000] 5 CMLR 1074 --- 62-64, 175

Notice on agreements of minor importance [2001] OJ C368/13 [2002] 4 CMLR 699 --- 63, 175

## ***JAPAN***

Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (Antimonopoly Act): Act No. 54 of 14 April 1947

Art. 1 --- 119

Art. 2(5) --- 30

Art. 2(6) --- 30, 165

Art. 2(7) --- 30

Art. 2(9) --- 72

Art. 3 --- 30, 92, 139, 146

Art. 8 --- 30

Art. 9 --- 32

Art. 19 --- 30, 71, 28, 139, 170

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## **AUTHOR'S DECLARATION**

I declare that, except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature \_\_\_\_\_

Printed Name \_\_\_\_\_



## **LIST OF ABBREVIATIONS**

ABA: American Bar Association  
AML: Antimonopoly Law  
CFI: Court of First Instance  
CPU: Central Processing Unit  
CR: Concentration Ratio  
DOJ: Department of Justice  
EC: European Community  
ECJ: European Court of Justice  
EU: European Union  
FTA: Free Trade Agreement  
FTC: Federal Trade Commission  
GWB: Gesetz gegen Wettbewerbsbeschränkungen  
HCI: Heavy and Chemical Industry  
HHI: Herfindahl-Herschman Index  
IMF: International Monetary Fund  
JFTC: Japan Fair Trade Commission  
KFTC: Korea Fair Trade Commission  
KRW: Korean Currency Won  
MITI: Ministry of International Trade and Industry  
MNC: Multinational Corporation  
MRFTA: Monopoly Regulation and Fair Trade Act  
OECD: Organization for Economic Cooperation and Development  
OJ: Official Journal  
R&D: Research and Development  
RPM: Resale Price Maintenance  
SII: Structural Impediments Initiative  
SME: Small and Medium-Sized Enterprise  
UBP: Unfair Business Practice  
UNCTD: United Nations Conference on Trade and Development

## Chapter 1

### Introduction

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#### 1.1. Global and Comparative Perspectives in Competition Policy on Vertical Restraints

Competition policy on vertical relations has come to assume an important position, not only for domestic competition concerns, but also international economic concerns, because business activities commonly transcend national borders.<sup>1</sup> There is no perfect industrial sector without distribution, and the commercial world is becoming increasingly interdependent. Multinational Corporations (MNC) look for distributors to sell their products in foreign markets, and spend enormous effort to develop strategies and improve their distribution systems. This activity can be highlighted in the field of competition law. A competition authority should consider the effects of global competition through international trade, influencing vertical levels in the domestic market. This influence of globalisation from foreign competition awakens competition authorities' interest, since this issue is also related to the state economy. Therefore, states have made efforts to create a framework of competition law to solve the problems, not only of public trade restraints, but also private. However, this is not an easy task.

In particular, regimes in small market economies face a dilemma, whereby the aims of their competition laws are in conflict with national macroeconomic policies of trade. For this reason, competition policy on vertical relations remains one of the most difficult subjects for competition authorities in small market economies, because vertical relations can influence domestic and international competition. Moreover, the issue of whether vertical relations are

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<sup>1</sup> See Eleanor Fox, 'Competition Law' in Andreas Lowenfeld, *International Economic Law*, 2nd edn, Oxford University Press, Oxford, 2008, p. 418. For further discussion about complementarities between international trade and competition law, see also Kevin Kennedy, *Competition Law and The World Trade Organisation: The Limits of Multilateralism*, Sweet & Maxwell, London, 2001, pp. 2-5.

problematic has long been disputed, based on diverse microeconomic theories. Therefore, vertical arrangements in domestic and global markets are directly related to macro- and microeconomic policy. The competition regime in the Republic of Korea (hereafter referred to as Korea), as a small market economy, has faced the task of implementing a sound competition law for all of these reasons.

Vertical relations can be divided into two areas, vertical integration and vertical restraint. Vertical integration can be thought of as integration between firms at different levels of transaction. This can inhibit competition, where it forecloses the market by means of extension of monopoly, or raising rivals' costs. It can also expand market concentration, thereby creating a monopolistic or oligopolistic market. This anti-competitive result is more likely to occur where a market is highly concentrated. However, vertically integrated firms normally get some benefits from legal exemptions, compared with the horizontal merger. Despite some negative views on vertical integration, competition authorities generally take a less strict approach, because of their expectation of positive effects. Vertical integration may be crucial in some industrial sectors, especially those in their early stages. It is beneficial for a national economy regarding efficiency concerns, when a firm performs some functions for itself, and should otherwise purchase goods from foreign firms with higher prices.<sup>2</sup> Therefore, the incentive of vertical integration occurs when the integration of the manufacturer and distributor relationship is advantageous, such as from reduction of transaction costs,<sup>3</sup> and this incentive encourages a national economic policy on vertical integration.

Vertical restraint is also related to the supply of goods or services between two or more firms, located at different stages of the production and distribution level. A firm might be a manufacturer, industrial purchaser, distributor, or local retailer. Whilst the main aim of anti-competitive horizontal restraints is a collusive strategy, the concern arising from vertical restraints is exclusive or foreclosure,<sup>4</sup> which may block international rivals. Vertical restraint

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<sup>2</sup> See Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, 3rd edn, West Publishing, St. Paul, MINN, USA, 2005, p. 374.

<sup>3</sup> See Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Economics of Regulation and Antitrust*, 4th edn, The MIT Press, Cambridge MA, USA, 2005, p. 236.

<sup>4</sup> See Peter Zweifel and Roger Zäch, 'Vertical Restraints: The Case of Multinationals', *The Antitrust Bulletin*, Vol. 48, No. 1, 2003, p. 273; Michael Whinston, *Lectures on Antitrust Economics*, The MIT Press, London, 2006, p. 133. A manufacturer may consider selling products to an independent distributor, or integrating the distribution function entirely. Vertical restraints are, thus, an intermediate solution between full independence and vertical integration.

is an essential feature of commercial life, and to some extent a substitute for vertical integration.<sup>5</sup> Vertical restraints impose restrictions on the commercial freedom of enterprises, according to certain agreements. Moreover, these practices can make consumers pay higher prices.<sup>6</sup> However, vertical restraints may enhance competition where they improve competition between brands; thus, controlling them is still one of the most controversial areas in competition law. Competition law scholars have debated whether vertical relations should be always defined as restrictions of competition, if these restraints have some negative effects on competition. If these are not always anti-competitive, many argue that it is necessary to ask to what degree competition authorities should allow them, according to research based on the market structure, and degree of entry barriers.

The academic issue of balancing effects from vertical restraints, therefore, increases the demand for revolutionary vertical regulations in developing countries, not only for eliminating trade barriers, but for the benefits from pro-competitive results. A competition authority needs to re-examine and reform its legal measures if its competition law allows excessive exemptions or, on the other hand, unnecessary restrictions on vertical restraints. Some may argue that, although economic analyses are essential to assess the effects of vertical restraints, competition law and policy still come in diverse forms, since policy-makers do not unanimously express one opinion on vertical practices. Furthermore, a mere legal reasoning or defective economic theory sometimes results in harm to competition and public policy.<sup>7</sup> It is thus not an easy task for a competition authority with a short history of competition legislation such as Korea. The Korea Fair Trade Commission (KFTC) is often criticised for its lack of experience of vertical restraint examination.<sup>8</sup> As the economics of vertical restraints improve, the KFTC needs to reassess diverse applications of competition laws.

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<sup>5</sup> See Mark Furse, *Competition Law of the EC and UK*, 6th edn, Oxford University Press, Oxford, 2008, p. 163.

<sup>6</sup> See Mat Hughes, 'The Economic Assessment of Vertical Restraints under UK and EC Competition Law', *European Competition Law Review*, Vol. 22, No. 10, 2001, p. 424; Alison Jones and Brenda Sufrin, *EC Competition Law: Text, Cases, and Materials*, 2nd edn, Oxford University Press, Oxford, 2004, p. 604.

<sup>7</sup> See Oliver Williamson, 'Assessing Vertical Market Restrictions: Antitrust Ramifications of The Transaction Cost Approach', *University of Pennsylvania Law Review*, Vol. 127, No. 4, 1979, p. 953.

<sup>8</sup> See Ho Young Lee, 'Su-Jik-Jok-Jae-Han-Go-Rae-Ui-Kyu-Jae (Regulations on Vertical Restraints)' in Ohseung Kwon (ed), *Gong-Jung-Go-Rae-Wa-Bub-Chi [Fair Trade and Regulation]*, Bubmunsa, Seoul, 2004, pp. 621-2.

Some may then question whether the Korean authority can adopt and apply various competition law techniques from such large, developed countries such as the US, the EC, and Japan. If it can, how much can it modify particular legal techniques, considering its own economic, political, and social consequences? In general, it can be assumed that competition authorities with a short history should adopt legal and economic structures from advanced competition regimes, regardless of their different economic and social structures. In particular, this assumption seems plausible when competition authorities rely heavily on the universalism of economic theories.<sup>9</sup> Nevertheless, each country has different economic and competition policies from each other. The Korean competition policy-makers have, of course, to examine their unique market features when they suggest better ideas, in reference to legal and economic theories in other regimes. They can learn other regimes' legal practices, which may give guidance on better paths for development,<sup>10</sup> and modify them to fit their own economy and market. Examining and criticising current working regulations is, therefore, important to find whether the existing regulations are satisfactory. If they are not, a comparative study is beneficial to solve the problems that cannot be solved by its own method, and this is what the KFTC needs to begin. This comparative analysis can offer a larger variety of solutions than could be made in a system in one country. However, the suggested reform should be tempered by the approach of a micro-comparative legal study,<sup>11</sup> because of its different circumstances in economy and cultural jurisprudence.<sup>12</sup>

## 1.2. Korean Brand Competition Law, Economic Growth and International Trade

The evolution of a national competition policy involves two different types of concerns. The first issue is the manner of competition law application, in order to make domestic firms compete vigorously with foreign firms for domestic competitiveness improvement. At the

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<sup>9</sup> See Damien Neven, Pénélope Papandropoulos, and Paul Seabright, *Trawling for Minnows: European Competition Policy and Agreements Between Firms*, Centre for Economic Policy Research, London, 1998, p. 17; Wolfgang Kerber and Oliver Budzinski, 'Competition of Competition Laws: Mission Impossible?' in Richard Epstein and Michael Greve (eds), *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy*, AEI Press, Washington D.C., 2004, pp. 36-40.

<sup>10</sup> See Eleanor Fox, 'Harmonization of Law and Procedures in a Globalized World: Why, What, and How?', *Antitrust Law Journal*, Vol. 60, 1991, p. 595.

<sup>11</sup> See Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law*, 3rd edn, Oxford University Press, Oxford, 1998, p. 3.

<sup>12</sup> See Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, p. 14.

same time, competition law should ensure fair benefits for consumers and Small and Medium-sized Enterprises (SME) from competition, as well as encouraging efficiency and innovation. Hence, globalisation through free trade eventually requires domestic competition laws and policies, which must not unsuitably weaken the potential for competitiveness of domestic enterprises in global markets. The second issue concerns the opportunity for foreign firms to increase their market shares in the domestic market. Domestic consumers may get benefits from tough competition through international interaction, but domestic firms are put in danger of losing their market shares, as their international rivals gain a foothold.<sup>13</sup> Thus, a different type of foreign restraint has been implemented to attract the attention of policy-makers in Korea. Market access restraints by private enterprises foreclose their markets to the foreign.<sup>14</sup> This can happen where domestic firms have power to establish entry barriers in the vertical level.

Because of all these concerns, the KFTC should take distinct policies on vertical restraints for the different market structures and different aims of competition laws. It should be concerned about domestic competition policy regarding international trade and economic growth, whilst simultaneously examining current regulations of vertical practices. The rapid economic growth of Korea made policy-makers consider adopting the models and methods applied in the leading competition regimes such as the US, the EC and, mainly, Japan. Some commentators even argue that the Korean competition policy on vertical relations gets its influence largely from US antitrust law.<sup>15</sup> However, Korean competition policy differs from the US, due to its unique economic characteristics and concentrated market structure, which have influenced Korean competition policy as well as macroeconomic policy. Certain

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<sup>13</sup> See Carl Green and Douglas Rosenthal, *Competition Regulation in the Pacific Rim*, Oceana Publications Inc., New York, 1996, Foreword.

<sup>14</sup> Eleanor Fox, *Supra.*, note 1, p. 428.

<sup>15</sup> See John Haley, *Antitrust in Germany and Japan: The First Fifty Years, 1947-1998*, University of Washington Press, Seattle and London, 2001, p. 3; Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsa, Seoul, 2005; Cassey Lee, 'Model Competition Laws' in Paul Cook et al (eds), *Competitive Advantage and Competition Policy in Developing Countries*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2007, p. 29. Lee states that, for example, Thailand in drafting its competition law borrowed from Korea, which in turn was influenced by Japanese and German competition laws. Moreover, Japanese and German authorities implemented their laws during the occupation period by the US. The historical contexts out of which competition policy developed in Japan and Germany appear in many respects to be similar. However, there are some differences between the two regimes. Germany chose competition, the free market, and single market integration. Japan opted for pervasive governmental guidance, industrial policy, and trade protection. Each regime has developed its own competition law based on its economic and cultural background. As a unique feature, therefore, the Korean competition law whose legal technique is different from others can also influence other countries.

competition techniques which work successfully in other regimes simply do not apply to the Korean market. Besides, the increase in international trade and the demand for economic development raises apprehensions about the Korean vertical structure, since the market is highly dominated by a few large enterprises. In particular, their strategic vertical relations have demonstrated noteworthy influence in the market and national economy.

The outcome of economic development policy in Korea caused the problem of market concentration through coordination with large conglomerates, the so-called *Chaebols*.<sup>16</sup> Korean competition policy has focused on fairness, in other words, equality of opportunity for all businessmen. However, most Korean *Chaebols* have used forms of vertical integration and distribution channels, and this structure has restricted competition. This has made Korean competition policy on vertical relations different from other countries. The historical development of Korean competition law through amendments shows that the KFTC has strengthened regulations on business conglomerates.<sup>17</sup> Because the influence of *Chaebol* has been very significant in the Korean market, the amendments have, until recently, been intended to reduce their inefficient and unfair business practices. *Chaebols* have a unique corporate structure, only existing in Korea, and have also played an important role in the business environment of the market. They have practised market dominant positions through vertical integration and restraints in order to increase shares in the foreign market, such as by leverage strategies. The government caused the emergence of *Chaebols*, coordinating with them and supporting their export-led policy during the 1960-70s, allowing *Chaebols*' total monopolies, for the benefit of rapid economic growth. *Chaebols*, from their inception, have generated considerable side-effects, creating an oligopolistic market. However, since competition law legislation in 1980, their business strategy has been changed, as Korean government economic policy has been amended. They could no longer stick to old-fashioned business practices, even though these had brought them their past success.

Since the beginning of Korean competition law legislation, the KFTC has sought to rein in the law, by providing consumer and SME protection, rather than efficiency. This was practical in the early days of legislation, since there were significant restraints on administration in international trade, and the only thing the KFTC had to do was to restrict

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<sup>16</sup> *Infra.*, Chapter 2 and glossary.

<sup>17</sup> The first amendment to the Korean competition act in 1986 already confirmed its aim of competition policy of prohibition on market concentration.

large firms, disregarding the influx of foreign competition. However, because public restraints have been very much reduced since then, the KFTC should reconsider the aims of Korean competition law. It needs, of course, to investigate whether the current law is sufficient to eliminate or reasonably reduce the problem of market access restraints, hence creating a welfare increase through a fair share for consumers. Excessive relaxation of restrictions on vertical arrangements may increase anti-competitive problems in the Korean market. It should, however, reassess the benefits from efficiency-improvement by vertical restraints. The KFTC needs to allow efficiency-enhancing vertical restraints where they do not harm domestic competition and international trade. In conclusion, the KFTC is required to trade-off between the positive and negative effects of vertical restraints on micro- and macroeconomic levels. The crucial technique to balance them is a sufficient degree of tolerance within the criteria to prohibit anti-competitive practices. Considering all of these issues, the KFTC has to create a new vertical regulation through reforms.

### 1.3. Research Questions and Structure of Thesis

This thesis intends to examine current Korean competition law and policy on vertical relations, particularly vertical restraints. This eventually aims to suggest a regulatory reform of Korean type vertical regulation, thereby preventing the *Chaebols*' anti-competitive effects, and also to improve efficiency and international trade. This thesis reflects two aspects of study of Korean vertical regulation. The first is the stress placed on an explanation of why Korean vertical regulation should be different from other regimes, based on historical perspectives. The second element is the exposure to benefits from vertical restraints and changing ideas about them. It is time for the KFTC to prepare a new vertical regulation that fits into the market and economy, which will trade-off the negative and positive effects by vertical restraints. This thesis, therefore, brings some questions to bear on this research outcome. First, how and why did *Chaebols* emerge in the Korean market, and what are the main anti-competitive concerns about their abusive conduct through vertical relations? Second, what are the distinctive approaches of the KFTC to vertical restraints, and what are the problems in its policy and regulation, as reviewed in the cases? Third, how can the KFTC and the courts develop competition law, through amendments and case law, which fit into the Korean market and economy?



In this thesis, the following major issues should be brought to bear on these questions: (i) fear of unwieldy size and market foreclosure; (ii) failure to apply proper provisions; (iii) development of clear guidance; (iv) balance and trade-off tests; and (v) implementation of appropriate objectives of competition law. These issues can be explained as following: first, *Chaebols* have tried to set up, or already established, domestic market entry barriers through vertical integration and restraints, which can be called a ‘market containment effect,’ since *Chaebols*, or even large foreign firms, can foreclose the Korean market geographically, without high costs of predation.<sup>18</sup> Second, although the Korean market becomes more open, the KFTC does not expect more vigorous competition, and is heavily concerned about market dominance. This anti-largeness policy makes the KFTC fail to implement proper provisions. Third, the KFTC has not given clear guidance on the application of relevant provisions, e.g., market share threshold, which could result in legal certainties. Fourth, reasonable balance and trade-off tests by rule of reason will be necessary in vertical cases to foster competition. All of these new approaches may achieve the aims of competition law. This thesis, therefore, focuses on the most recent developments in Korean competition policy on vertical restraints and suggestion of a new idea.

This thesis consists of eight chapters, including an Introduction and Conclusion. Chapter 2 introduces the historical development of the Korean economy and competition law with a comparison with the Japanese case, since Korean economic and competition models were influenced by the Japanese. The objective of this chapter is to provide a brief overview of the historical development of Korean competition law through government economic policy, focusing on international competence by large firms. It discusses how and why the Korean economy was developed through the *Chaebol* policy, and depicts the evolution of competition law legislation. It also clarifies why rapid economic growth brought negative side-effects, such as economic concentration, and a danger of domino effects of *Chaebol*’s failure.<sup>19</sup> These problems were caused from the lack of well-equipped competition law during the period of economic growth policy fuelled by export fever. This chapter illustrates the

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<sup>18</sup> E.g., *Intel Corp., Intel Semiconductor Ltd, and Intel Korea*, KFTC Decision 2008-295, 2007*Dokgam*1790 and 2008*Sijang*1126, Nov. 5, 2008. *Intel*’s market share in Korea was even larger than that in the world market.

<sup>19</sup> *Chaebol*’s affiliated enterprises brought high risks of their groups’ failure from the cross-debt guarantee system.

legislation of competition law in 1980 and amendments to control *Chaebol*. This will give an idea about the objectives of Korean competition law.

Chapter 3 analyses the rationales of vertical relations, which discusses the arguments of pro- and anti-competitive effects, mainly from vertical restraints. Economic explanations are necessary to articulate problems such as extension of monopoly, commitment and restoration of market power, raising rivals' costs, and, also, benefits of inter-brand competition and blocking free-riding. Economic theories are, therefore, very useful to explain why competition authorities have a less strict application of legal approaches to vertical arrangements, and this debate is helpful in comparing various competition policies on vertical practices. This chapter thus has a comparative overview of historical development in other competition regimes, such as the US and the EC because these regimes have developed their enforcements on vertical restraints by means of diverse legal methods. These can help the KFTC and the courts attempt to experiment economic theories to vertical cases. After this explanation, it provides a summary of substantive statutory provisions, the Monopoly Regulation and Fair Trade Act (MRFTA), particularly Articles 3-2, 19, 23, and 29 MRFTA<sup>20</sup> and guidelines with a comparison with the Japanese Antimonopoly Law (AML). The MRFTA was heavily influenced by the AML. Therefore, this comparison will be helpful to analyse the current laws in these two regimes whether they are pro-competitive and result in efficiency outcomes.

Chapter 4 explains the case law, and also the KFTC's practices. This demonstrates how the KFTC and the courts in Korea have been cautious to deal with vertical restraints, and how they have developed justifications in vertical cases. This chapter compares the case law development with other jurisdictions. This chapter intends to explore the essential implementation of the law. This is critically reviewed, and it is necessary to explain the problems of existing Korean vertical regulation for the proposal of reform in the following chapters. The main part of this chapter is concerned with a discussion of the economics-justification methods in case law.

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<sup>20</sup> MRFTA, amended by the law no 9554, Mar. 25 2009, Article 3-2 (Prohibition of Abuse of Market Dominance); Article 19 (Unfair Concerted Act); Article 23 (Unfair Business Practices); Article 29 (Resale Price Maintenance).

The emphasis shifts, in Chapter 5 and 6, to the problems of regulatory structure in vertical regulation, then amendments. Chapter 5 continues critical analyses of the current Korean competition law of vertical restraints from the cases studied in Chapter 4. In this chapter, the problem of application of law as a technical matter is discussed. It examines the issues in Article 3-2 MRFTA, the provisions of abuse of market dominance, application of Articles 19 and 23 regarding concerted and unilateral problems, and Article 29 of resale price maintenance. This chapter also discusses the problems according to the relevant guidelines, which do not give legal certainty, but only create strait-jacket effects. To establish a model of Korean brand vertical regulation and case law development, Chapter 5 also deals with legal ideas on vertical restraints as well as economic theories. Therefore, it discusses controversial legal arguments in interpretation of relevant provisions regarding the achievement of purposes of Korean competition law. Chapter 6 then introduces a regulatory reform of Korean vertical regulation by an amendment, which can be thought as revolutionary. Chapter 6 suggests various ideas of reform regarding presumption of abuse of market dominance in Articles 3-2 and 4 MRFTA, application of Articles 19 and 23, and withdrawal of Article 29. This chapter also proposes new vertical guidelines, which include market share threshold test. This mainly argues that the current MRFTA is very strict and may not satisfy the aims of Korean competition law.

Chapter 7 critically assesses the new model that is suggested in Chapter 6. This chapter examines the issues for small market economies of developing countries and competition policy, including concerns about opening the domestic market. On theoretical grounds, there are number of reasons why the KFTC should follow a more economics-justification approach in vertical restraints, where the market is becoming mature, and open to international competition. This chapter focuses on the development of Korean vertical regulation as a model of balancing negative and positive effects, based on these grounds. This gives an example of how competition authorities in small market economies, which have similar experiences or circumstances in micro- and macroeconomic policies, should provide legal measures, and apply their laws in order to enhance economic efficiency and pro-competitive effects. Finally, Chapter 8 concludes the ideas in the thesis.

Various elements are comprehensive factors in the determination of anti- and pro-competitiveness of vertical restraints, depending on the degree of market concentration and

international trade. This thesis attempts to examine the Korean case as an example of a developing country, regarding competition law, and also international trade. This thesis provides insight into the historical development of economic and societal changes which influence competition culture. As the Korean economy presumably grows gradually, the Korean competition authority should and will develop regulatory techniques more quickly than expected. The KFTC has been one of the most active authorities, particularly amongst Asian countries. Therefore, because developing countries can have a similar experience of a highly concentrated market with the pursuit of export-enhancing policy, the study of Korean competition law and policy on vertical restraints will be valuable to anticipate or suggest development and changes in their competition laws. In conclusion, this thesis will trace and forecast the development of Korean competition law and policy, and also give an example of development of vertical regulations.

## Chapter 2

# Historical Development of Korean Economy and Competition Law

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### 2.1. Korean Economic Policy of Rapid Economic Growth and Its Costs

In many developing countries in East Asia, including Korea, competition policy will tend to lose out if there is a conflict with other government policy objectives. Government policies, which influence the competitiveness of their domestic firms in international markets as well as the welfare of consumers, involve not only traditional trade policy, but also competition policy.<sup>1</sup> Governments frequently intervene in business activities to promote certain industries. Such an environment makes it difficult to establish a culture of competition. Competition laws thus vary in terms of their coverage and content, reflecting diverse social, political,<sup>2</sup> cultural and legal contexts.<sup>3</sup> Therefore, the important factor to understand competition policy is what the underlying economic problem is. At almost all points, economic theories are usually part of social or political philosophy.<sup>4</sup>

There are some reasons to believe that less mature markets, especially in developing countries, tend to be more vulnerable to anti-competitive practices. The reasons include high entry barriers<sup>5</sup> due to inadequate business infrastructure, such as distribution channels of

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<sup>1</sup> See Jonathan Eaton and Gene Grossman, 'Optimal Trade and Industrial Policy under Oligopoly', *The Quarterly Journal of Economics*, Vol. 101, No. 2, 1986, p. 383.

<sup>2</sup> See Bruce Doern, 'Comparative Competition Policy: Boundaries and Levels of Political Analysis' in Bruce Doern and Stephen Wilks (eds), *Comparative Competition Policy: National Institutions in A Global Market*, Clarendon Press, Oxford, 1996, p. 34.

<sup>3</sup> See Ping Lin, 'The Evolution of Competition Law in East Asia' in Erlinda Medalla (ed), *Competition Policy in East Asia*, Routledge, London and New York, 2005, p. 16.

<sup>4</sup> See Eleanor Fox, 'Economic Concentration, Efficiencies, and Competition: Social Goals and Political Choices' in Eleanor Fox and James Halverson (eds), *Industrial Concentration and the Market System: Legal, Economic, Social and Political Perspectives*, ABA Publishing, USA, 1979, p. 140.

<sup>5</sup> See Sigrid Stroux, *US and EC Oligopoly Control*, Kluwer Law International, The Hague, 2004, pp. 23-4. The author illustrates 3 types of entry barriers: (i) legislation; (ii) technology; and (iii) strategies set up by firms.

large firms. High entry barriers make it easier to achieve market power, and can also prevent the erosion of monopoly power in the long run. Therefore, once achieved, concentration may not be easily undone in a short period.<sup>6</sup> In general, consumers and Small and Medium-sized Enterprises (SME) in these countries could be harmed by anti-competitive practices. For this reason, there are increasing demands to protect them against abuses of market dominance.<sup>7</sup>

The Korean case conforms to this model. Korean competition enforcement cannot be separated from the economy's historical, social, and political background.<sup>8</sup> The outstanding economic development of Korea over the six decades after the Korean War was surprising, and became legendary to other developing countries. Since the early 1960s, Korea has demonstrated remarkable economic growth and change in economic structure.<sup>9</sup> During the time of its economic growth, government intervention influenced the allocation of resources amongst market entities.<sup>10</sup> Although this intervention seemed to be similar to other Asian countries, especially Japan, fundamental Korean government policy was slightly different, due to its unique strategy of export-led industrialisation policy. Selective industrial policies for export contributed to Korea's rapid economic success and international competitiveness in several industries.<sup>11</sup> To achieve this export-led economic goal, the government had to rely on the specific enterprises that could give best effort for export, and compete with other Multinational Corporations (MNC). This policy eventually led to significant economic improvement, with market concentration by several business groups, *Chaebols*, which have

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<sup>6</sup> See Michal Gal, *Competition Policy for Small Market Economies*, Harvard University Press, Cambridge MA, USA and London, 2003, p. 75.

<sup>7</sup> See Robert Anderson and Frédéric Jenny, 'Competition Policy, Economic Development and the Possible Role of a Multilateral Framework on Competition Policy: Insights from the WTO Working Group on Trade and Competition Policy' in Erlinda Medalla (ed), *Competition Policy in East Asia*, Routledge, London and New York, 2005, p. 63.

<sup>8</sup> See David Round, 'Regional Cooperation in Competition Policy' in Erlinda Medalla (ed), *Competition Policy in East Asia*, Routledge, London and New York, 2005, p. 252.

<sup>9</sup> See Ha-Joon Chang, *The Political Economy of Industrial Policy*, St. Martin's Press, New York, 1994, p. 92; Paul Kuznets, 'Causes, consequences, relevance: Korea's industrialization' in Yun-Shik Chang and Steven Lee (eds), *Transformations in Twentieth Century Korea*, Routledge, 2006, New York, p. 102. Between 1965 and 1986, Korea's annual per capita GNP growth showed 6.7 per cent that was significantly high compared with that of 2.9 per cent of the developing world as a whole.

<sup>10</sup> See Larry Westphal, 'Industrial Policy in an Export Propelled Economy: Lessons From South Korea's Experience', *The Journal of Economic Perspectives*, Vol. 4, No. 3, 1990, p. 41. These were taxes and subsidies, credit rationing, various licensing, and creation of public enterprises.

<sup>11</sup> *Ibid.*, p. 41; Paul Kuznets, *Supra.*, note 9, pp. 89-92.

numerous affiliates.<sup>12</sup> They were always associated with governmental interference in production and distribution.<sup>13</sup>

This policy meant heavy reliance on a few large enterprises at the cost of their anti-competitive activities, and was later criticised heavily. It was also obvious that the closed domestic market for foreign competitors could not improve international competitiveness, because there was less foreign interaction. In the end, the state-aided domestic large enterprises chosen as national champions could not be transformed into competent international firms.<sup>14</sup> This economic policy for rapid growth eventually brought economic distortions, and also created government resource allocation and an artificially-structured market concentration.<sup>15</sup> During this period, many argued that this was essential to develop the Korean economy in order to provide economic competence. Therefore, it was inevitable that this export-motivated nature brought a high level of centralisation to achieve scale economies for future international competition. It was unquestionable that the government-sponsored export-led policy accelerated growth maximisation by coordinating the advantages of market intervention.

Although this policy brought growing exports in a large number of foreign markets, as planned, the state-supported enterprises achieved tremendous market dominance in the domestic market. Whilst the government emphasised the gains from large enterprises' competitive advantages in the foreign market, it ignored the importance of competition law. A large number of domestic industries were restrained by them, and the domestic market became monopolistic or oligopolistic.<sup>16</sup> In addition, the government instructed individual enterprises as to which industries were open to them, and used the banking system to implement its policy. This allowed them to enjoy market dominance to increase their market

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<sup>12</sup> For further details about *Chaebol* structure, see Myoungsu Hong, 'Features of Chaebol', *Journal of Korean Competition Law*, Vol. 9, 2003, pp. 170-71.

<sup>13</sup> See Paul Kuznets, 'Government and Economic Strategy in Contemporary South Korea', *Pacific Affairs*, Vol. 58, No. 1, 1985, p.55; Seung-Wha Chang, 'Competition Law and Policy in Transaction' in Carl Green and Douglas Rosenthal (eds), *Competition Regulation in the Pacific Rim*, Oceana Publication, New York, 1996, p. 263; Ho Young Lee, 'Regulation of Undue Internal Dealings under the Monopoly Regulation and Fair Trade Act', *Journal of Korean Law*, Vol. 4, No. 2, 2005, p. 87.

<sup>14</sup> See Tat Yan Kong, *The Politics of Economic Reform in South Korea: A Fragile Miracle*, Routledge, London and New York, 2000, p. 109.

<sup>15</sup> See Un-Chan Chung, 'The Korean Economy Before and After the Crisis' in Duck-Koo Chung and Barry Eichengreen (eds), *The Korean Economy Beyond the Crisis*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2004, pp. 25-6.

<sup>16</sup> Seung-Wha Chang, *Supra.*, note 13, p. 263.

power,<sup>17</sup> although market power should have been viewed as tending to damage efficiency and economic progress.<sup>18</sup>

The Korean government, in a word, granted licences to *Chaebols* to operate in various fields of businesses, particularly those seen to be strategic to economic development. This demonstrated its tendency of protecting producer's interests over those of consumers. Since the dominant concern for the policy-makers was how to achieve rapid growth, it was easy to understand the relative imbalance in the government's focus. One example of economic policies favouring producers over consumers was the restriction on imports, which prevented most imports of consumer goods. This restriction has recently been phased out for the most part. However, the entry barriers against foreign enterprises in the Korean market during this period can be seen to have led to a resulting lack of competition, which ultimately brought inefficiency to the market.<sup>19</sup>

As a result, the Korean economy became very vulnerable, even to a small external or internal economic shock, and could easily go into an economic crisis when there is a loss of confidence in its economic prospects. This is what Korean policy-makers learned, at a considerable cost, in 1997, when they received loans from the International Monetary Fund (IMF). They recognised a considerable and harmful market distortion from the high economic concentration.<sup>20</sup> In fact, a concern about the oligopolistic market structure arose from the view of competition aspects in 1980. As the Korean public demanded more democratic procedures to accompany economic growth and globalisation, the politics-

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<sup>17</sup> Un-Chan Chung, *Supra.*, note 15, pp. 25-6. On the financial side, poor monitoring practices and the politicisation of funding increased non-economic performing loans. This was the core figure amongst the large business groups, which was similar to the concerns brought in Japanese competition law. See also Masako Wakui, *Antimonopoly Law: Competition Law and Policy in Japan*, Arima Publishing, Suffolk, 2008, p. 20.

<sup>18</sup> Some scholars distinguish market power from monopoly power as the latter is often defined in the cases as the power to control price or to exclude competition and understood as a significant degree of market power. However, in the Korean system, these two terms seem to be treated as the same. For further discussion about the definition, see William Shepherd, 'Theories of Industrial Organization' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, p. 37; Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Antitrust Analysis: Problems, Text, and Cases*, 6th edn, Aspen Publishing, New York, 2004, p. 368; Luc Peeperkorn and Vincent Verouden, 'The Economics of Competition' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, Oxford University Press, Oxford, 2007, p. 9.

<sup>19</sup> For discussion about inefficient results by *Chaebol*, see Sung-Hee Jwa, *A New Paradigm for Korea's Economic Development: From Government Control to Market Economy*, Palgrave, New York, 2001, pp. 12-3; Myoungsu Hong, *Supra.*, note 12, pp. 155-61.

<sup>20</sup> Un-Chan Chung, *Supra.*, note 15, pp. 25-6. The author explains that inefficient and unprofitable firms were supposed to be shut down, and only efficient firms should survive, but the Korean large firms continued to develop by taking advantages from governmental protection.



business practices became untenable.<sup>21</sup> The concept of unfairness in competition has influenced competition law and policy in Korea, which resulted in a unique *Anti-Chaebol* policy.<sup>22</sup> The market has been affected by tough competition, which was dependent on competition law. This historical development of the Korean economy and competition law has influenced competition in the Korean market.

Before moving to the substantive Korean competition laws, it is thus important to get an idea of the variety of competition aims from the historical background. This will provide a grounding knowledge of the relationship between macroeconomic and competition policies in Korea. This will also give explanations for the problems in competition law of vertical restraints. This chapter will address how the Korean competition system has been identified, based on national economic development and the fear of large firms, which resulted in an extreme treatment by *Anti-Chaebol* policy.

## 2.2. Historical Context of Competition Law Development

### 2.2.1. *Chaebol* and Problems of Market Concentration: Comparative Perspective

There were two notable features of Korea's economic development. One was the economic leadership of the government, and another was the emergence of *Chaebols*.<sup>23</sup> These large family-owned conglomerates had roots in the colonial period. The government leadership was a part of Korea's colonial inheritance from the 1930s, when the Japanese colonial administration used private banks to direct resources towards heavy industries, under the large business groups, *Zaibatsu*.<sup>24</sup> To Korean policy-makers, the Japanese government-led, *Zaibatsu*-driven development was considered suitable for the Korean economy. The Japanese

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<sup>21</sup> See Uk Heo and Sunwoong Kim, 'Financial Crisis in South Korea: Failure of the Government-Led Development Paradigm', *Asian Survey*, Vol. 40, No. 3, 2000, p. 503.

<sup>22</sup> See Kwangshik Shin, 'Kyoung-Jae-Wi-Ki-Wa-Kyoung-Jaeng-Jeong-Chaek (Economic Crisis and Competition Policy and Law)' *Journal of Economic Policy*, Vol. 20, No. 1 and 2, 1998, p. 8.

<sup>23</sup> See Gerardo Ungson, Richard Steers, and Seung-Ho Park, *Korean Enterprise: The Quest for Globalization*, Harvard Business School Press, Boston, 1997, pp. 24-7; Tat Yan Kong, *Supra.*, note 14, p. 168. See also glossary.

<sup>24</sup> For further discussion about *Zaibatsu*, see Eleanor Hadley, *Antitrust in Japan*, Princeton University Press, Princeton, 1970, pp. 20-21; John Haley, *Antitrust in Germany and Japan: The First Fifty Years, 1947-1998*, University of Washington Press, Seattle and London, 2001, p. 9; David Flath, *The Japanese Economy*, 2nd edn, Oxford University Press, Oxford, 2005, pp. 46-9. See also glossary.

case hints at a valuable description for development of Korean competition law and policy on large business groups.

*Zaibatsu* were groups of powerful enterprises from the banking, coal, steel, heavy industry, trading, securities, and other sectors.<sup>25</sup> In particular, sales of plants, contracts and subsidies from the Japanese government helped to concentrate the development of transportation and heavy industry in the hands of a small group of families. *Zaibatsu* were the main economic tools for Japanese economic growth during the 1930-40s, correspondingly for the Korean case in the 1960-70s.<sup>26</sup> They were restructured during post-war US military occupation and evolved into the present-day *Keiretsu*<sup>27</sup> by the legislation of the Antimonopoly Law (AML).<sup>28</sup> This was introduced in 1947 as part of the occupation policy after the Second World War, and has often been seen as one of the main issues concerning the Japanese economy.<sup>29</sup> The AML is an inheritance of US occupation, and thus has some features in common with US antitrust law. For example, some features of the Sherman Act and the Clayton Act were incorporated into the Japanese statute, such as ‘conspiracy in restraint of trade’ and ‘tend to monopolise’.<sup>30</sup> The AML has been often the focus of political controversy, although it seems an important tool in the Japanese government’s efforts to make the market more compatible with other countries.<sup>31</sup>

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<sup>25</sup> See Mitsuo Matsushita, *Introduction to Japanese Antimonopoly Law*, Yuhikaki Publishing, Tokyo, 1990, p. 1; Kenji Suzuki, *Competition Law Reform in Britain and Japan: Comparative Analysis of Policy Networks*, Routledge, London and New York, 2002, p. 37.

<sup>26</sup> For further information about emergence of *Zaibatsu* and the AML, see Hiroshi Iyori and Akinori Uesugi, *The Antimonopoly Laws of Japan*, Federal Legal Publications, Washington, 1983, pp. 4-10; Mitsuo Matsushita, *Supra.*, note 25, preface; Hidemasa Morikawa, *Zaibatsu: The Rise and Fall of Family Enterprise Groups in Japan*, University of Tokyo Press, Tokyo, 1992, Chapter 2.

<sup>27</sup> See Kenichi Miyashita and David Russell, *Keiretsu: Inside the Hidden Japanese Conglomerates*, McGraw-Hill, New York, 1994, Chapter 1; Akira Goto and Kotaro Suzumura, ‘Keiretsu’ in Leonard Waverman, William Comanor and Akira Goto (eds), *Competition Policy in The Global Economy: Modalities for Cooperation*, Routledge, London and New York, 1997, pp. 362-7. See also glossary.

<sup>28</sup> The AML was first named as ‘Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade’. This seems that Japan took the pure microeconomic concept of competition rather than macroeconomic idea. For further discussion, see Masako Wakui, *Supra.*, note 17, pp. 12-3.

<sup>29</sup> See Peter Beck, ‘Revitalizing Korea’s Chaebol’, *Asian Survey*, Vol. 38, No. 11, 1998, pp. 1018-9.

<sup>30</sup> David Flath, *Supra.*, note 24, pp. 250-1. Although the MRFTA adopted a number of provisions in the AML, it did not adopt ‘monopolisation clause’.

<sup>31</sup> See Mitsuo Matsushita, ‘The Antimonopoly Law in Japan’ in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington D.C., 1997, p. 151; Kenji Suzuki, *Supra.*, note 25, p. 35.

*Chaebols* can be compared with *Zaibatsu* or present-day *Keiretsu*,<sup>32</sup> in that direct industrialisation reappeared in the 1970s, when the administration tried to establish and develop Heavy and Chemical Industries (HCI). Government-driven *Chaebolisation* was generated to avoid the risk of entering new and risky industries, through its financial support.<sup>33</sup> By the end of the 1970s, the most successful of those favoured business groups developed into highly diversified *Chaebols*. The 1970s represented the decisive stage in the formation of the *Chaebols*. Many of the economic and social distortions commonly associated with *Chaebols* originated during this time. This was detrimental to competition.<sup>34</sup> They possessed features that have contributed to their longevity.<sup>35</sup> *Chaebols* grew larger, generating the common sentiment and theory of ‘too big to fail’.<sup>36</sup> One may ask why they diversified into many economic activities through affiliates, although there was often a loss, instead of specialisation. A possible answer might be that such expansion helped to spread the risk, allowing the slack in one sector to be compensated for by the others. However, instead of spreading risk, their affiliates were so intertwined through cross-shareholdings<sup>37</sup> that the collapse of one was likely to trigger a domino effect throughout the groups. Another answer for diversification could be the desire for vertical integration within the group, to ensure the supply of critical parts of manufacturing,<sup>38</sup> and also to foreclose the market.<sup>39</sup>

Vertical integration or diversification into unrelated areas took the form of creation or acquisition of enterprises, which resulted in entry barriers.<sup>40</sup> Based on this consideration, the government started focusing on SMEs, because most of its *Chaebol* policy during the 1960-70s drove anti-competitive effects onto the market. The growth of *Chaebols* soon became a

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<sup>32</sup> *Chaebol* has its structural similarity with *Keiretsu* and also *Konzern* but it is still very unique and some scholars argue that it cannot be compared with the large groups in other regimes. See Myoungsu Hong, *Supra.*, note 12, pp. 186.

<sup>33</sup> Paul Kuznets, *Supra.*, note 9, pp. 93-5; Seung-Ho Kwon and Chung-Sok Suh, ‘Transformations in Korean capitalism: A case study of the Hyundai Business Group’ in Yun-Shik Chang and Steven Lee (eds), *Transformations in Twentieth Century Korea*, Routledge, New York, 2006, pp. 127-8.

<sup>34</sup> See Jongwoo Han and L.H.M. Ling, ‘Authoritarianism in the Hypermasculinized State: Hybridity, Patriarchy, and Capitalism in Korea’, *International Studies Quarterly*, Vol. 42, No. 1, 1998, pp. 67-8; Tat Yan Kong, *Supra.*, note 14, pp. 47-51.

<sup>35</sup> Paul Kuznets, *Supra.*, note 9, p. 94.

<sup>36</sup> Sung-Hee Jwa, *Supra.*, note 19, pp. 10-11.

<sup>37</sup> Un-Chan Chung, *Supra.*, note 15, p. 27.

<sup>38</sup> See Gary Hamilton and Nicole Biggart, ‘Market, Culture, and Authority: A Comparative Analysis of Management and Organization in the Far East’, *The American Journal of Sociology*, Vol. 94, 1988, p. S65; Tat Yan Kong, *Supra.*, note 14, pp. 88-90.

<sup>39</sup> For further discussion about vertical foreclosure in the oligopolistic market, see Esther Gal-Or, ‘Vertical Integration in Oligopoly’, *Journal of Law, Economics, & Organization*, Vol. 8, No. 2, 1992, p. 393.

<sup>40</sup> See Sea Jin Chang and Unghwan Choi, ‘Strategy, Structure and Performance of Korean Business Groups: A Transactions Cost Approach’, *The Journal of Industrial Economics*, Vol. 37, No. 2, 1988, pp. 429-30.

burden to economic policy. Accountable as they were for a large share of the Korean economy's assets, sales and debts, *Chaebols* inevitably influenced the majority of industrial policy measures. From their privileged positions, *Chaebols* initiated large-scale projects without fear. Their strategic concerns in oligopolistic markets forced them to expand their capacity through 'market containment power'.<sup>41</sup> This market structure sufficiently satisfied the first legislation of Korean competition law, to solve *Chaebols*' dominating situations so that the free market system works well.<sup>42</sup> This was different from the Japanese case, since there was no foreign pressure for competition law legislation.

### 2.2.2. Establishment of Korean Competition Policy

In the 1950s and 60s, after liberalisation from Japanese rule, and the Korean War, both Presidents Rhee and Park aimed to establish heavy industries that could produce more industrialisation,<sup>43</sup> and put economic development as a top priority. That was what most people wanted. The government-business relationship was created during this time, and private sector cooperation with government administrators arose from a combination of nationalism and shared interests.<sup>44</sup> The government actively participated in the public and private sectors of the economy, achieving its position through government-driven economic planning.<sup>45</sup> This targeted certain industries during the 1960-70s for their implementation and execution.<sup>46</sup> The case of the 'Flour, Sugar, and Cement' price cartels in 1963, however, brought public concerns about abusive conduct of monopolists and demanded competition law legislation.

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<sup>41</sup> Sung-Hee Jwa, *Supra.*, note 19, pp. 10-11; Hyun Yoon Shin, *Kyoung-Jae-Bub [Korean Competition Law]*, 2nd edn, Bubmunsa, Seoul, 2007, p. 32. Shin explains that this 'unbalanced economic growth policy' brought the wide government's control.

<sup>42</sup> In general, the primary purpose of the competition law should be to remedy situations in which the free market breaks down. See Mark Furse, *Competition Law of the EC and UK*, 6th edn, Oxford University Press, Oxford, 2008, p. 1.

<sup>43</sup> See Steven Lee, 'Introduction: Korea's twentieth century transformation' in Yun-Shik Chang and Steven Lee (eds), *Transformations in Twentieth Century Korea*, Routledge, New York, 2006, p. 17.

<sup>44</sup> Ha-Joon Chang, *Supra.*, note 9, pp. 110-11; Tat Yan Kong, *Supra.*, note 14, pp. 140-41. A number of the features of anti-competitiveness could be seen even after competition law legislation, such as shared interests between the government and *Chaebols*.

<sup>45</sup> Gary Hamilton and Nicole Biggart, *Supra.*, note 38, p. S77.

<sup>46</sup> In the 1960-70s, the government was strong enough to resist the societal pressures that might have undermined its long-term economic priorities. See Steven Lee, *Supra.*, note 43, p. 17.

For this reason, the government first attempted to propose price stabilisation legislation. Following this government's attempt, the Law Institute of Seoul National University submitted the 'Fair Trade Act Proposal' in 1964. However, because *Chaebols* strongly hindered this proposal, policy-makers could not enact competition law.<sup>47</sup> In the 1970s, concerns about domestic competition arose again due to the problems of inflation, distortion of competition, and concentration of economic power. In particular, worries about the monopolistic market increased significantly. Therefore, the government reconsidered legislation. Although the first legislation effort was made in 1964, the most significant endeavour was implemented in 1972 for stabilising prices and controlling inflation caused by the oil shock,<sup>48</sup> which could make policy-makers re-evaluate competition law legislation, because of the oil shock's effect on industry.

Direct price controls were provided under the Price Stabilisation Act in 1973 for the surging prices. This act was legislated to establish fair trade by forbidding refusal to sell and achieve price control on goods and services. After this, the government implemented further legislation, the Price Stability and Fair Trade Act,<sup>49</sup> enacted in 1975. By revising the Price Stabilisation Act, this clarified the prohibition of unfair business practices, and provided a legal groundwork for issuing corrective measures for violation of the law. This act also provided price settings, such as maximum prices, and prices for some products, including utilities. Furthermore, it stipulated directions for the supply and distribution of goods and the implementation of measures for coordinating supply and demand in the case of emergency. This statute was principally aimed at controlling price inflation rather than enhancing competition in the market, which was different from the Japanese legislation. These legislations, however, remained at an immature stage.

These acts created external issues, such as preventing proper functioning of the price mechanism, because the purpose of the statutes was mainly focused on attaining price stability. The attempted statutes eventually distorted competition and created the possibility

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<sup>47</sup> See Yong-Duk Jeon, 'Kyu-Jae-Ui-Ie-Ik-Jib-Dan-Ie-Ron-Kwa-Gong-Jung-Go-Rae-Bub (Theory of Regulated Interest Groups and Competition Law)', *Journal of Social Science Research* Vol. 6, No. 4, 1999, pp. 173-83; Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsa, Seoul, 2005, p. 93.

<sup>48</sup> See Ohseung Kwon, 'Dok-Jom-Kyu-Jae-Bub-Ui-Hyun-Hwang-Kwa-Kwa-Jae (Current Competition Law and the Problems)' in Ohseung Kwon (ed), *Gong-Jung-Go-Rae-Bub-Kang-Ui Vol. II [Lectures on Competition Law Vol. II]*, Bubmunsa, Seoul, 2000, p. 3.

<sup>49</sup> Price Stabilisation and Fair Trade Act, Law No. 2798, Dec. 31, 1975.

of inflation, which resulted in the refusal of production and creation of higher prices. In the end, the acts generated these external factors deepening the problems of the monopolistic and oligopolistic market. Whilst focusing on the failure of price regulation, the policy-makers saved the sections involving fair trade in the Price Stability and Fair Trade Act, and brought in new legislation.<sup>50</sup> This effort of modification became a cornerstone of the Monopoly Regulation and Fair Trade Act (MRFTA) in 1980. This effort on macroeconomic policy, which was not completely abandoned in the 1980s, exerted strong political pressure on the Korean competition system at the beginning of MRFTA legislation.<sup>51</sup> This legislation was only the first step towards the fully effective competition statute in the 1990s.<sup>52</sup>

Although economists have long advocated free trade as an ideal, nearly all market economies protect at least some industries from foreign competition. Korea was not an exception. Korea provided higher levels of protection in the 1960-70s than developed countries. In protecting a domestic industry from import competition, Korea risked imposing costs of market concentration, which was the increase of domestic monopolists' power.<sup>53</sup> This made the Korean public criticise the practices of *Chaebols* for their historical abuses of market power, thinking 'small is beautiful'.<sup>54</sup> Therefore, the MRFTA has been developed in order to restrict market concentration, rather than efficiency improvement, and has been supported by consumer groups and SMEs. The Korea Fair Trade Commission (KFTC) has implemented the law with stringent measures, focusing less on efficiency than protection of consumers and SMEs.<sup>55</sup> This seems influenced by the idea that competition law was not

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<sup>50</sup> The government published the reason for this legislation, stating 'the Korean market and the firms have developed, and if the government intervenes in the market activities, it may prevent the freedom of individual firms and distort market mechanism such as pricing; therefore, the government proposes the Fair Trade Act to enhance fair and free competition.' The KFTC website: <http://kftc.go.kr/eng> (accessed 11 Nov. 2006). This source is withdrawn.

<sup>51</sup> See Michal Gal, 'Reality Bites (Or Bits): The Political Economy of Antitrust Enforcement' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Corporate Law 2002*, Juris Publishing, Huntington NY, USA, 2002, p. 605. The author argues that small market economies show stronger political pressures on competition laws than large regimes, and this was the Korean case in the 1980s.

<sup>52</sup> For further discussion, see Hyun Yoon Shin, *Supra.*, note 41, p. 65; Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 6th edn, Bubmunsa, Seoul, 2008, pp. 40-41.

<sup>53</sup> See Paul Krugman, 'Protection in Developing Countries' in Rudiger Dornbusch (ed), *Policymaking in the Open Economy: Concepts and Case Studies in Economic Performance*, Oxford University Press, Oxford, 1993, p. 127.

<sup>54</sup> See Kwangshik Shin, *Supra.*, note 22, p. 16.

<sup>55</sup> See Seungchul Lee, *Gong-Jung-Go-Rae-Kyoung-Jae-Hak [Antitrust Economics]*, Korea Economics Research Institute, Seoul, 1999, pp. 30-31.

adopted to maximise the greatest possible efficiency outcome and, therefore, it should help consumers rather than penalise them.<sup>56</sup>

### 2.2.3. Modification of Policies through Financial Crisis: Competition Law Experiment

*Chaebols'* economic influence became even more pervasive in the 1980s, due to their expansion and leading role in the frontier industries.<sup>57</sup> Implementations such as increasing the number of large scale economies through mergers in the 1980s continued, resulting in entry barriers. The ultimate privilege of economic power had already been obtained to assure their survival, regardless of how incompetent and inefficient they might be.<sup>58</sup> Furthermore, they could still create erosion of economic freedoms.<sup>59</sup> This feature of market concentration was seen in Korea in the 1980s. The main reasons were the short history of competition law implementation and policy-makers' misunderstandings. They were extremely concerned about excessive competition between domestic enterprises, and assumed severe competition in the domestic market might cause social waste from 'destructive competition',<sup>60</sup> for example, by price wars that could be harmful to enterprises. The fear of excessive competition allowed the policy-makers to provide laws in the form of entry restrictions.<sup>61</sup>

This implication was wrong, because the policy-makers did not fully understand competition as a means to achieve efficiency. This eventually made the society demand vigorous social aims in competition policy, such as protection of consumers and SMEs.<sup>62</sup> Competition law came into being in 1980, after four abortive attempts at legislation in 1964, 1966, 1969, and 1971. However, the MRFTA in 1980 claimed to be concerned mainly with restricting unfair or anti-competitive behaviours rather than market concentration, which could not solve foreclosure by large firms. Not until 1986 did criticism and concerns about the concentration of economic power of large business groups bring the first amendment to

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<sup>56</sup> See Eleanor Fox and Lawrence Sullivan, 'Antitrust-Retrospective and Prospective: Where Are We Coming From? Where Are We Going?', *New York University Law Review*, Vol. 62, 1987, p. 957.

<sup>57</sup> Tat Yan Kong, *Supra.*, note 14, pp. 131-2.

<sup>58</sup> For theoretical argument, see Walter Adams and James Brock, 'The Sherman Act and the Economic Power Problem' in Theodore Kavaleff (ed), *The Antitrust Impulse: An Economic, Historical, and Legal Analysis, Vol. I*, M.E. Sharpe, New York, 1994, p. 350.

<sup>59</sup> *Ibid.*, p. 533; Giuliano Amato, *Antitrust and the Bounds of Power: the Dilemma of Liberal Democracy in the History of the Market*, Hart Publishing, Oxford, 1997, p. 2.

<sup>60</sup> This issue was discussed by Callmann. See Rudolph Callmann, 'The Essence of Anti-Trust', *Columbia Law Review*, Vol. 49, No. 8, 1949, p. 1101.

<sup>61</sup> Ha-Joon Chang, *Supra.*, note 9, pp. 112-25.

<sup>62</sup> Hyun Yoon Shin, *Supra.*, note 41, p. 131.

the MRFTA, with stronger restrictions on cross-investments between affiliates of the same business group.<sup>63</sup> Domestic pressures for thoroughgoing reform of economic policies also grew. To improve technology, finance, and market structure, further effort for vigorous competition was needed.

One can observe the transition of the 1990s by looking at official policy orientation, and the pace and scope of change. Economic policy was refined during this time, notably through functional support, and economic deconcentration measures. These performances brought more effective competition law, with the correction of imbalances that underpinned the economy's high cost and low efficiency.<sup>64</sup> The government found that government intervention was incompatible with liberalised policy, and that traditional economic controls restrained outward expansion of Korean businesses. To compete with foreign firms, Korean firms also had to maximise their efficiency, by taking advantage of opportunities for global production.<sup>65</sup> The *Chaebol* reform was attempted by successive governments in the 1980s, but in each case the effort ultimately failed because of lack of consent within the economic bureaucracy, i.e., the businessmen with vested interests. The Korean government, at last, acted on the external crisis in 1997, and subsequent IMF assistance to bring real reform.<sup>66</sup> In fact, the financial crisis provided Korea with an opportunity to re-examine its overall economic policy. In this process of reflection, the importance of competition policy was highlighted.<sup>67</sup>

In particular, many argue that the open market was necessary in order to improve the international competitiveness of domestic firms, and this could be achieved through the adoption of a global standard and principle of market economy.<sup>68</sup> With the financial crisis, a broad consensus seemed to be reached that the economy should be driven by market

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<sup>63</sup> Ha-Joon Chang, *Supra.*, note 9, p. 112; Ohseung Kwon, *Supra.*, note 52, pp. 41-2.

<sup>64</sup> Tat Yan Kong, *Supra.*, note 14, pp. 15-6.

<sup>65</sup> *Ibid.*, p. 159; Myoungsu Hong, *Chaebol-Ui-Kyoung-Jae-Ryuck-Jib-Jung-Kyu-Jae [Regulations on Economic Concentrations of Chaebol]*, Kyoungin Publishing, Seoul, 2006, p. 1.

<sup>66</sup> Peter Beck, *Supra.*, note 29, p. 1021; Ohseung Kwon, *Supra.*, note 47, pp. 77-8. Most of the reforms were focused on restrictions on holding companies and affiliates, such as controls of cross-shareholding and debt-guarantee etc.

<sup>67</sup> See Nam-Kee Lee, *Toward A Mature Market Economy: Competition Law and Policy in Korea*, Korea Fair Trade Commission, Seoul, 2002, p. 143; Michael Todaro and Stephen Smith, *Economic Development*, 7th edn. Pearson Education Ltd, USA, 2006, pp. 654-8.

<sup>68</sup> See In-Ho Kim, 'Han-Kuk-Kyoung-Jae-Wa-Kyoung-Jaeng-Jung-Chek-Ui-Kwa-Jae (Assignments for the Korean Economy and Competition Policy)' in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, p. 75.



competition. The KFTC took bold steps to eliminate the old structural inefficiencies of the Korean economy, and aimed at strict enforcement of competition law to restructure the Korean economy. Following the financial crisis, Korea, like other countries in Asia, has been working towards eliminating entry barriers and other anti-competition elements, hastening the transformation of previously government-led economies into more market-based ones. The weakness of market discipline allowed Korean firms to pursue growth rather than profitability in the 1960-70s.<sup>69</sup> In this context, the MRFTA has been amended significantly, with a view to supporting restructuring of the economy.<sup>70</sup> However, the KFTC already demonstrated signs of progress in implementing competition law before the financial crisis, and this accelerated reform after 1997.<sup>71</sup>

The historical development of Korean economic and competition policy is similar to that of Japan. Japanese industrial policy also played a crucial role in achieving Japan's economic miracle during the 1960-70s. This was the prime reason for the government's lack of interest in enforcing the AML. To enhance the competitiveness of Japanese firms in international markets and to catch up with more advanced economies, Japanese ministries, particularly the Ministry of International Trade and Industry (MITI), encouraged measures that contradicted the principle of competition. Japanese firms had to be as large as other foreign competitors in order to compete with them effectively. The Japanese government gave more weight to industrial policy than competition. Since the early 1990s, however, the AML has been significantly strengthened and enforcement has improved.<sup>72</sup>

Looking at law enforcement, Korea and Japan have had a similar approach. At the beginning of legislation, they did not seem to be strict in controlling market power, but since the 1990s both have tried to increase restrictions on large firms. However, the financial crisis in 1997 was the crucial period for the KFTC to balance the macro- and microeconomic approaches to its competition policy. The financial crisis was instrumental in alerting its

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<sup>69</sup> See Won-Am Park and Gongpil Choi, 'What Caused the Crisis? A Post Mortem' in Duck-Koo Chung and Barry Eichengreen (eds), *The Korean Economy Beyond the Crisis*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2004, p. 54.

<sup>70</sup> See Sai Ree Yun, 'Antitrust Law in Korea' in Barry E. Hawk (ed), *International Antitrust Law and Policy: Fordham Corporate Law 2003*, Juris Publishing, Huntington NY, USA, 2003, p. 507.

<sup>71</sup> For example, a number of cases, which were investigated and reported during the 1990s, increased significantly compared with the 1980s. See The KFTC Report, March 1996, pp. 22-8.

<sup>72</sup> Ping Lin, *Supra.*, note 3, pp. 22-4; Michael Beeman, *Public Policy and Economic Competition in Japan: Change and Continuity in Antimonopoly Policy, 1973-1995*, Routledge, London and New York, 2002, pp. 13-24.

economy to the desirability of regulating firms through both trade and competition policies.<sup>73</sup> Furthermore, Korean competition policy has been treated slightly differently from the Japanese. Korea legislated competition law without any foreign compulsion, whilst Japan adopted the law due the influence of the US.<sup>74</sup> This different historical origin caused a tremendous difference in application, because the public recognised the problem of market concentration, demanding vigorous enforcement without foreign pressure.

With the conclusion of Japanese occupation and the Korean War, the Korean economy entered a period of unparalleled growth. This seems to be similar to other developed countries.<sup>75</sup> The government-led economic policy was considered efficient and essential for the small scale Korean economy at the beginning of development, and other considerations about social welfare and competition law were disregarded. However, Korean market structure in the 1980s became more complicated than in the 1960-70s. Moreover, the public started taking into account the necessity of competition legislation for the Korean market.<sup>76</sup> Nevertheless, this atmosphere of competition was a social objective, such as equality in wealth rather than efficiency, which has been influenced by competition scholars in Korea.

The ideal competition law for efficiency has long been regarded as a secondary objective, because of other social ideals for protection of consumers and SMEs. This social objective has hindered development of Korean competition law. This has also brought tensions between liberty and equality, which can be observed in other regimes.<sup>77</sup> Generally, the political fate of the competitive free-market ideal is heavily involved with developments in competition law. The struggle between economic freedom and regulation thus reflects and

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<sup>73</sup> David Round, *Supra.*, note 8, p. 251.

<sup>74</sup> Ping Lin, *Supra.*, note 3, p. 34. Japan's 1947 AML was imposed by the Allied Occupation Forces, and extensive changes of the 1990s were a response to the pressure from the US. In Taiwan the threat of trade retaliation from the US also played a decisive role in the passage of the competition act in 1991.

<sup>75</sup> See Eleanor Fox and Lawrence Sullivan, 'Retrospective and Prospective: Where Are We Coming From? Where Are We Going?' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, p. 3. The authors state that the US economy also had an experience of unparalleled growth attributable to several factors such as emergence of national markets, innovation of new technologies, and vast amounts of capital.

<sup>76</sup> See Nam-Kee Lee, '2002 Nyun-Gong-Jung-Go-Rae-Jung-Chaek-Un-Yong-Bang-Hyang (Competition Policy in 2002)' in Kwon Ohseung (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsu, Seoul, 2002, pp. 38-39.

<sup>77</sup> See Rudolph Peritz, 'A Counter-History of Antitrust Laws', *Duke Law Journal*, Vol. 1990, No. 2, 1990, p. 285. The author argues this issue could be observed in the US historical development of rule of reason.

reacts upon the tension in society between the ideals of liberty and equality. Korean competition policy, such as that of other regimes, has also experienced the dilemma of preventing monopolists in a manner that did not excessively interfere with their freedom to transfer property.<sup>78</sup> In summary, there are three features reviewed in the history of Korean competition legislation: first, the government deeply intervened in market competition at the beginning of industrialisation, causing market concentration by *Chaebols*; second, market dominance by *Chaebols* awakened the fear of large companies, ultimately resulting in strict enforcement; and third, this has created an emphasis on competition law enforcement aimed at achieving social objectives.

### 2.3. Framework of Korean Competition Law and Policy

#### 2.3.1. General Features of Korean Competition Law

Most competition laws, including the MRFTA, contain rules that prohibit agreements and prohibit or control the conduct of dominant firms, and mergers. Horizontal cartels are the major concern and target of competition law, because these unambiguously harm competition through raising prices or lowering output. Competition may also be harmed by acts of monopolisation and attempts to monopolise,<sup>79</sup> or abuse of dominance, and, more rarely, by vertical restraints. The term ‘competition’, however, has diverse meanings in the competition law of different jurisdictions. In the US, lessening of or harming competition is found when the conduct creates or increases market power. The harm is revealed not only in higher prices or lower output, but in lessening innovation in highly concentrated markets to the detriment of buyers, and ultimately, consumers.<sup>80</sup> Other systems for the protection of competition have somewhat different points of focus.<sup>81</sup>

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<sup>78</sup> For further comparison with the US, see also William Letwin, *Law and Economic Policy in America: The Evolution of the Sherman Act*, The University of Chicago Press, Chicago and London, 1965, p. 7; Robert Bork, *The Antitrust Paradox: A Policy at War with Itself*, The Free Press, New York, 1993, p. 10.

<sup>79</sup> However, the MRFTA does not prohibit monopolisation or attempts to monopolise.

<sup>80</sup> See Eleanor Fox, ‘Competition Law’ in Andreas Lowenfeld, *International Economic Law*, 2nd edn, Oxford University Press, Oxford, 2008, pp. 431-2. Consumer welfare can be maximised when 2 conditions hold: (i) goods should be produced, distributed, and marketed using available resources to meet consumer demand; (ii) goods should be sold at prices that are consistent.

<sup>81</sup> See Charles Rule and David Meyer, ‘An Antitrust Enforcement Policy to Maximise the Economic Welfare of All Consumers’ in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, pp.212-3. In the EC, for example, the case law on

In particular, the meaning of competition in Korea is different from the US. The MRFTA provides terms, ‘unfairness’ and ‘unreasonableness’ which probably originated from historical concerns about the economic power of *Chaebols*. Unequal bargaining power brought by *Chaebols* could often be called unfair. In the Korean jurisdiction, competition may promote fairness in the setting of prices close to cost, and of alternatives for buyers and sellers, although it is a vague claim.<sup>82</sup> The major function of Korean competition law mistakenly regarded the tool in order to maximise the total amount of content in society for equality of wealth<sup>83</sup> as limiting the power of *Chaebols*. This idea originated from the emphasis on equality or fairness through government intervention in the 1980 Constitution amendment.<sup>84</sup> This was from fear of too large companies, and the desire for dispersal of power, although the efficiency of such a move must have been doubted.<sup>85</sup> Although the KFTC and the courts have tried to define these terms through the cases, it is not easy to apply them in practice concurrently. However, the KFTC and courts have recently started examining cases under the measure of anti-competitiveness, rather than unfairness.<sup>86</sup>

Korean competition law is often considered as an example of a public-policy process in which it is still widely assumed that government is motivated by the goal of serving the public interest in current court judgments.<sup>87</sup> A number of court judgments in Korea use this

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abuse of dominance often has reference to behaviour that unbalances the playing field, and to acts by dominant firms that exclude, coerce, or exploit weaker firms, or create entry barriers across national borders. Law and policy statements refer to protecting market actors as well as consumers, and preserving the freedom to trade between Member States. Nonetheless, differences are narrowing, and most systems today regard efficiency or consumer welfare as a prime object of the law.

<sup>82</sup> Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 18, p. 22.

<sup>83</sup> See A.P. Thirlwall, *Growth and Development: With Special Reference to Developing Economies*, 7th edn, Palgrave Macmillan, Hampshire, 2003, pp. 91-3.

<sup>84</sup> For further detail, see Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, pp. 4-5.

<sup>85</sup> For further discussion of issues in utilitarianism and distribution of wealth, see Richard Posner, *Frontiers of Legal Theory*, Harvard University Press, Cambridge MA, USA and London, 2001, Chapter 3; Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 18, p. 21; Mark Furse, *Supra.*, note 42, p. 276. Posner argues that utilitarianism is not a reliable guide to social policy.

<sup>86</sup> E.g., *POSCO v KFTC*, Supreme Court 2002Du8626, Nov. 22, 2007. See also Michal Gal, *Supra.*, note 6, p. 7. The author argues that a culture of competition is linked to other social goals, and this also influenced the wording fairness.

<sup>87</sup> E.g., *Korean Medical Association v. KFTC*, Supreme Court 2001Du5347, Feb. 20, 2003; *Daewoo v. KFTC*, Supreme Court, 2001Du2935, Oct. 14, 2004. The Court in these cases emphasised that violation of the law shall be determined solely from the perspective of fair transactional order, public interest and consumer welfare. Some scholars argue that competition law is one of the remaining government intervention policies for public interest. For more discussion about public interest and intervention, see Dominick Armentano, *Antitrust and Monopoly*, 2nd edn, The Independent Institute, Oakland, USA, 1990, pp. 10-11; William Shughart II, ‘Public-Choice Theory and Antitrust Policy’ in Fred McChesney and William Shughart II (eds), *The Causes and*

term, public interest, as a criterion to determine the legitimacy of public intervention into the private sector.<sup>88</sup> This means that intervention can be legitimised, although some sacrifice of private right is assumed during the public procedure.<sup>89</sup> Based on this, the Korean policy-makers started to consider legislation of competition law known as *Kyoung-Jae-Bub* (literally, ‘Economic Law’).<sup>90</sup> Economic law or the Korean competition law<sup>91</sup> was primarily legislated and amended to guarantee a sound market order. It includes the MRFTA, the main and crucial statute, and also consists of other supplementary statutes regarding advertising, electronic commerce, and subcontracting.<sup>92</sup> Since the MRFTA is the essential statute as the major competition measure against other legal provisions, it is regarded as the fundamental competition law in Korea.<sup>93</sup>

The MRFTA aims to promote creative business activities and protect consumers by facilitating fair and free competition in the market, and comprises all fundamental issues of competition policy. In particular, the MRFTA rules on matters of undue subsidies, debt guarantees, and equity investment amongst affiliates of large business groups, which are unique to Korea and Japan.<sup>94</sup> It also gives the KFTC the authority to investigate possible violations, including rights to investigate, order submission of information, maintain custody of materials, and impose surcharges and corrective measures.<sup>95</sup> The MRFTA, including

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*Consequences of Antitrust: The Public-Choice Perspective*, University of Chicago Press, Chicago and London, 1995, pp. 8-11; Michal Gal, *Supra.*, note 6, p. 51; Keith Hylton, *Antitrust Law: Economic Theory and Common Law Evolution*, Cambridge University Press, Cambridge, 2003, pp. 37-9.

<sup>88</sup> This is probably the influence of Arts. 2(5) and (6) AML. These prohibit business activities that are contrary to the public interest.

<sup>89</sup> See Seong Wook Heo, ‘The Concept of “Public Interest” Demonstrated in Korean Court Precedents’, *Journal of Korean Law*, Vol. 6, 2006, p. 93.

<sup>90</sup> Hyun Yoon Shin, *Supra.*, note 41, p. 5. This Korean term is brought from the German word, ‘*Wirtschaftrecht*’. For further details about *Wirtschaftrecht*, see also Doris Hildebrand, *The Role of Economic Analysis in the EC Competition Rules*, 2nd edn, Kluwer Law International, The Hague, 2002, p. 3.

<sup>91</sup> Korean scholars call the Korean competition law literally as economic law. However, this will refer to the Korean competition law.

<sup>92</sup> For further details of these supplementary provisions, see Ho Young Lee, *Dok-Jum-Kyu-Jae-Bub [Monopoly Regulation and Fair Trade Act]*, Hongmunsa, Seoul, 2005, pp. 300-302.

<sup>93</sup> Ohseung Kwon, (Current Competition Law and the Problems), *Supra.*, note 48, p. 4; Ohseung Kwon, *Supra.*, note 47, p. 14.

<sup>94</sup> The special provisions regarding prevention of further growth of market power are: Arts. 8-2 and 8-3 MRFTA (Restrictions on Holding Company); Art. 9 (Prohibition of Cross-Shareholding); Art. 10 (Ceiling on Total Amount of Shareholding in other Domestic Companies); and Art. 10-2 (Prohibition of Debt Guarantees for Affiliated Company). For a comparison with the Japanese AML, see also Hideaki Miyajima, ‘Regulatory Framework, Government Intervention and Investment in Postwar Japan: The Structural Dynamics of J-Type Firm-Government Relationships’ in Hideaki Miyajima, Takeo Kikkawa, and Takashi Hikino (eds), *Policies for Competitiveness: Comparing Business-Government Relationships in the ‘Golden Age of Capitalism’*, Oxford University Press, Oxford, 1999, pp. 47-8.

<sup>95</sup> For further explanation, see Nam-Kee Lee, *Supra.*, note 67, p. 103.

regulation of monopolies and consumer protection, is generally considered to be an integral part of competition policy as emphasised in Articles 3-2, 19, 23 and 29 MRFTA.<sup>96</sup> Some scholars have shown that authorities in some developing countries clarify that they are interested in competition rules primarily to foster economic development.<sup>97</sup> Other countries focus on the implications of competition policy for market access.<sup>98</sup> However, the MRFTA's legislative history demonstrates its predominant concern for consumers and SMEs, which was solely intended as a means of protecting them from large firms.<sup>99</sup>

The authority of the MRFTA comes from the Constitution of Korea.<sup>100</sup> The Constitution guarantees human rights,<sup>101</sup> freedom of labour,<sup>102</sup> protection and limits of personal property rights,<sup>103</sup> and free market economic order based on a respect for the freedom of enterprises<sup>104</sup> and individuals in Korea.<sup>105</sup> In particular, the establishment of the MRFTA was made in accordance with Article 119(2) of the Constitution. It states that the state may regulate and coordinate economic affairs to maintain balanced economic growth and stability and to ensure proper income distribution,<sup>106</sup> prevent market dominance and abuse of economic power, and also to democratise national economy through harmony. This

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<sup>96</sup> This is very similar to Art. 82 EC and its wording of 'unfair'. Art. 82 EC has its main objective the protection of consumers, which requires the protection of an undistorted competitive process on the market. See Neelie Kroes, 'Tackling Exclusionary Practices to Avoid Exploitation of Market Power: Some Preliminary Thoughts on the Policy Review of Article 82' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Competition Law 2006*, Juris Publishing, Huntington NY, USA, 2006, pp. 385-6.

<sup>97</sup> See Dina Waked, 'Competition Law in the Developing World: The Why and How of Adoption and Its Implications for International Competition Law', *Global Antitrust Law Review*, Issue 1, 2008, pp. 82-4.

<sup>98</sup> See Douglas Melamed, 'International Antitrust in an Age of International Deregulation', *George Mason Law Review*, Vol. 6, 1998, pp. 444-5.

<sup>99</sup> For further details, see Hyun Yoon Shin, *Supra.*, note 41, pp. 66-81. This development seems to be similar to the early US legislative history. For further discussion, see also Robert Bork, *Supra.*, note 78, p. 64.

<sup>100</sup> Hyun Yoon Shin, *Supra.*, note 41, pp. 36-9.

<sup>101</sup> Under the Art. 10 Constitution of Korea, all citizens are assured human worth and dignity, and have the right to pursue happiness. It is the duty of the state to confirm and guarantee the fundamental and inviolable human rights of individuals.

<sup>102</sup> Art. 15 Constitution.

<sup>103</sup> Art. 23(1) Constitution.

<sup>104</sup> The term, 'enterpriser' under Art. 2(1) MRFTA refers similar to enterprise, company, firm or undertaking in other regimes.

<sup>105</sup> Arts. 119(1) and 127(1) Constitution. The government in 1980 started recognising the problems from government-led policies and provided a constitutional background to support the MRFTA legislation. This amendment supported government to regulate and control the problems in the monopolistic market. See also Ohseung Kwon, *Supra.*, note 47, pp. 43-4.

<sup>106</sup> Ohseung Kwon, *Supra.*, note 47, pp. 57-8; William Baldwin, *Market Power, Competition, and Antitrust Policy*, Homewood, Illinois, USA, 1987, p. 56. Baldwin also argues that one negative effect of the use of market power is to affect income redistribution. The monopolist raises price to increase profits, thus gaining wealth at the expense of its customers. The law-makers in Korea have considered this problem more than other issues.

sets a foundation of legal assurance and limitation of individual possessory rights to implement competition law.<sup>107</sup>

Finally, Korean competition law was somewhat influenced by the Japanese and German acts. For example, the priority of the KFTC's policy was upon supervising and addressing Unfair Business Practices (UBP) that might impair competition.<sup>108</sup> This idea of the UBP provision under Article 23 MRFTA is an influence from Japan. The MRFTA has a similar structure to the AML. As enacted, the AML reflects its US origins. Combining features of the US Sherman, Clayton, and Federal Trade Commission (FTC) Acts, the AML contains broadly worded general and specific prohibitions. Unlike the US legislation, however, the AML and also the MRFTA depend more on administrative than judicial interpretation.<sup>109</sup> There are three basic categories of conduct prohibited by the AML,<sup>110</sup> namely (i) private monopolisation,<sup>111</sup> (ii) cartels or unreasonable restraint of trade,<sup>112</sup> and (iii) unfair trade practice (hereafter also called UBP).<sup>113</sup> The MRFTA however has four pillars: (i) prohibition of market dominance, (ii) control of economic concentration such as Merger and Acquisition (M&A) and holding companies, (iii) restriction of improper concerted acts (horizontal agreements), and (iv) restriction of UBP.<sup>114</sup> In overall, the MRFTA was legislated mainly under the influence of the AML, the German Act, *Gesetz gegen*

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<sup>107</sup> Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 84, pp. 6-7; Ohseung Kwon, *Supra.*, note 52, pp. 54-5.

<sup>108</sup> See Soon-Sik Ju, 'Current Trends in Korea's Competition Law/Policy' in Chao et al. (eds), *International and Comparative Competition Law and Politics*, Kluwer Law International, The Hague, 2001, pp. 181-2.

<sup>109</sup> John Haley, *Supra.*, note 24, p. 71.

<sup>110</sup> See Mitsuo Matsushita, *Supra.*, note 25, pp. 5-10; Tatsuyoshi Masuda, *Antimonopoly Law of Japan: An Empirical Study*, Taga Shuppan, Tokyo, 1996, p. 8; Jiro Tamura, 'Competition Policy in Japan: A New Necessity for A Mature Economy' in Carl Green and Douglas Rosenthal (eds), *Competition Regulation in The Pacific Rim*, Oceana Publications, New York, 1996, p. 202. However, some have different opinions about the AML categorises such as: (i) prohibition of private monopolisation or unreasonable restraint of trade (Art. 3); (ii) prohibited acts of a trade association, filing requirement (Art. 8); and (iii) prohibition of UBPs (Art. 19).

<sup>111</sup> Art. 2(5) AML. Private monopolisation (*shiteki-dokusen*) and unreasonable restraints of trade (*futō-na-torihiki-seigen*) both are prohibited under Art. 3. Presumption of market dominance clause is Art. 2(7) AML. Other provisions closely related to the prohibition of private monopolisation can also be found in Chapter 4 of the AML: (i) the prohibition of holding companies, (ii) certain limitations on shareholding by large enterprises, (iii) the control of share acquisitions by corporation, and (iv) merger regulation. This part is equivalent to the second pillar of the MRFTA.

<sup>112</sup> Art. 2(6) AML defines a cartel, and Art. 8 also states the provisions on trade association activities.

<sup>113</sup> *Fukōsei-na-torihiki-hōhō*. Based on translation, it could be called UTP but hereafter it will be consistently named UBP. It consists of refusal to deal, unreasonable pricing, unreasonable inducement and coercion of customers, unreasonable conditions attached to transactions, abuse of bargaining power, and unreasonable interference in the affairs of competitors. For details, see also Mitsuo Matsushita, *Supra.*, note 25, p. 8; John Haley, *Supra.*, note 24, p. 72. Matsushita argues that the UBP provision was established for protection of consumers and SMEs.

<sup>114</sup> Some Japanese scholars also argue the AML has 4 pillars, same as the MRFTA categories. See Masako Wakui, *Supra.*, note 17, p. 5.

*Wettbewerbsbeschränkungen* (GWB), and also US law.<sup>115</sup> The MRFTA has a unique provision of UBP, influenced by the AML, which is actively implemented. This originates from the ideal of protecting fairness rather than competition.<sup>116</sup>

### 2.3.2. Purposes of Korean Competition Law and Comparative Outlook

The MRFTA has taken legal frameworks from other competition regimes. However, the MRFTA is not only a copy of other competition laws, but has had to be modified for the unique market structure and economy. The major domestic markets were already dominated by a few large business groups by the late 1970s.<sup>117</sup> Hence, the competition authority had to tackle the concerns over concentration of the economic power of *Chaebols*, although in initially legal implementation was not easy. The currently amended MRFTA in 2009 makes clear its aim as inhibition of dominance. The Constitution also states the purpose of restrictions and intervention of public authorities as mentioned above. These goals can presumably be achieved through fair and free competition with regulatory intervention. However, the language of free and fair competition in the MRFTA is unclear.<sup>118</sup> The KFTC does not distinguish differences between free and fair competition in practice because of its difficulty of interpretation.<sup>119</sup>

The concept of free competition can support a commitment to individual liberty and freedom from government power. However, if the public wants to regulate private economic power because private power corrupts, political oversights can be justified. Therefore, competition policy has long been regarded as a way of mediating tensions between commitments to freedom and equality.<sup>120</sup> This rhetoric has influenced Korean competition

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<sup>115</sup> Some also argue there have been more influences of the GWB than the US law to the AML, especially in the meaning of bargaining power. The MRFTA also inherited this. See Masako Wakui, *Supra.*, note 17, p. 29.

<sup>116</sup> *Infra.*, Chapter 5.

<sup>117</sup> Seung-Wha Chang, *Supra.*, note 13, p. 265.

<sup>118</sup> Ohseung Kwon, *Supra.*, note 47, pp. 79-80; Hyun Yoon Shin, *Supra.*, note 41, p. 132. Kwon explains that free competition can be established under the conditions of the open market, and fair competition refers to the circumstances of fair methods of business activities between firms. Shin also argues that free and fair competition can create allocative efficiency, and fair share of wealth distribution. This is a narrow definition of balanced economic growth. However, these definitions are still vague.

<sup>119</sup> See Young-Chul Lim, *Gong-Jung-Go-Rae-Bub [Korean Competition law]*, Bubmunsa, Seoul, 2007, p. 11.

<sup>120</sup> Seung-Wha Chang, *Supra.*, note 13, pp. 265-6; Ohseung Kwon, *Supra.*, note 47, p. 53. This could be commonly observed in other regimes. See also Rudolph Peritz, *Competition Policy in America: History, Rhetoric, Law*, Oxford University Press, New York, 1996, p. 3.



policy. There are also several major concepts in Article 1 MRFTA such as workable competition,<sup>121</sup> *Ordoliberalism*,<sup>122</sup> and efficiency.<sup>123</sup>

In general, the main objective of competition law should be to perfect the operation of the competitive market.<sup>124</sup> The competitive market can be described as one in which (i) every good is priced according to the cost of production and (ii) every buyer, who is willing to pay the price, can buy it. To create these circumstances, certain requirements to obtain an economic model of ‘perfect competition’ are necessary. This is the model of an industrial structure in which many small enterprises compete in the supply of a single product. The perfect competition model can be viewed as a central target of competition law. However, competition law does not always grant the conditions for perfect competition. Korean competition law also aims at perfect competition, although its analysis inevitably emphasises the complex imperfections of actual markets.<sup>125</sup> In other words, the MRFTA aims to create ‘workable competition’, because perfect competition can be a theoretical model, and also may be harmful to the market if an authority tries to create perfect competition artificially.<sup>126</sup>

In addition to this principle, Article 1 MRFTA articulates its aims as preventing the abuse of market dominance by excessive concentration of economic power of enterprises,<sup>127</sup> and regulating undue concerted acts and UBPs to promote fair and free competition. The

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<sup>121</sup> Ohseung Kwon, *Supra.*, note 47, p. 83.

<sup>122</sup> Korean competition law as well as other Korean statutes was influenced by the German legal system and the idea of *Ordoliberalism*.

<sup>123</sup> See Carl Kaysen and Donald Turner, ‘Antitrust Policy: An Economic and Legal Analysis’ in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, p. 181. The aims in the MRFTA are similar to that of the authors’ argument: (i) attainment of desirable economic performance; (ii) achievement and maintenance of competitive processes; (iii) prescription of fair competition; and (vi) prevention of undue growth of big business.

<sup>124</sup> See Frank Easterbrook, ‘The Limit of Antitrust’, *Texas Law Review*, Vol. 63, 1984, p. 1.

<sup>125</sup> For further discussion about perfect competition, see Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 18, p. 10; Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, 3rd edn, Thomson West, St. Paul, MINN, USA, 2005, p. 3.

<sup>126</sup> See Ohseung Kwon, ‘Gong-Jung-Go-Rae-Bub-Ui-Kae-Yo-Wa-Jaeng-Jum (Introduction to Competition Law and Arguments)’ in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, p. 5; Ohseung Kwon, ‘Retrospect and Prospect on Korean Antitrust Law’, *Journal of Korean Law*, Vol. 4, No. 2, 2005, pp. 3-4; Ohseung Kwon, *Supra.*, note 52, p. 75. For further discussion about the enforcement for workable competition, see also Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 18, pp. 29-32; Patrick McNutt, *Law, Economics, and Antitrust: Towards a New Perspective*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2005, p. 125.

<sup>127</sup> E.g., Arts. from 8 to 18 MRFTA restrict combination of enterprises and suppression of economic power concentration. This provision clearly shows how Korean competition law emphasises its restrictions on market concentration of large business groups. This provision controls not only mergers but also practices of Korean holding companies. This was created under the influence of Art. 9 AML.

ultimate aim is to ensure creative enterprise activities, protect consumer interests, and pursue a balanced economic development in order to provide workable competition. Therefore, Korean competition law also implemented the concept of *Ordoliberalism*,<sup>128</sup> whose goal of competition law was based on the concept of fairness. Under the form of economic law with regards to the ideal of the Constitution, in conjunction with *Ordoliberalism*, the MRFTA aims at correcting market concentration and anti-competitive market structure, with limits set by government intervention.<sup>129</sup> This aims for the market to best achieve fair distribution of its benefits.

Economic approaches to competition policy also proceed on the assumption that the goal of competition should be to foster resource allocation that is optimally efficient in satisfying a society's needs. In Korea, the analysis proceeds on the assumption that the goal of competition policy is to maximise net national welfare.<sup>130</sup> The definition of efficiency implicitly stated in Article 1 MRFTA is the key point. The law aims to achieve the goals of protection of consumers and SMEs, which do not necessarily harm large firms, by means of allocative or Pareto efficiency improvement. It also aims to achieve balanced economic growth through the improvement of productive and dynamic efficiencies. In short, the clause for protecting consumers and SMEs implies the improvement of allocative efficiency, and the concepts of economic growth and creative enterprises activities explain productive and dynamic efficiencies.<sup>131</sup>

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<sup>128</sup> For details about *Ordoliberalism*, see Giuliano Amato, *Supra.*, note 59, pp. 98-9; David Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus*, Clarendon Press, Oxford, 1998, pp. 239-52; John Haley, *Supra.*, note 24, p. 4; Steven Anderman and John Kallaughier, *Technology Transfer and the New EU Competition Rules: Intellectual Property Licensing after Modernisation*, Oxford University Press, Oxford, 2006, pp. 46-7; Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, USA, 2006, pp. 8-9; Giorgio Monti, *EC Competition Law*, Cambridge University Press, Cambridge, 2007, p. 23; Alison Jones and Brenda Sufrin, *EC Competition Law: Text, Cases, and Materials*, 3rd edn, Oxford University Press, Oxford, 2008, pp. 34-5.

<sup>129</sup> Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 84, pp. 12-3.

<sup>130</sup> See Janusz Ordover, 'Transnational Antitrust and Economics' in Barry Hawk (ed), *Antitrust and Trade Policy in International Trade*, Matthew Bender, New York, 1985, pp. 237-8. The author defines the net national welfare standard aggregates the citizens' consumer surplus and the profits of domestic firms earned in their domestic and export operations.

<sup>131</sup> For further discussion about efficiencies, see Dominick Armentano, *Supra.*, Note 87, pp. 15-7; Robert Bork, *Supra.*, note 78, pp. 91-106; Roger Van den Bergh and Peter Camesasca, *European Competition Law and Economics: A Comparative Perspective*, Intersentia, Antwerpen, Belgium, 2001, pp. 5-6; Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 18, p. 5; Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Economics of Regulation and Antitrust*, 4th edn, The MIT Press, Cambridge MA, USA and London, 2005, p. 79; Giorgio Monti, *Supra.*, note 128, p. 45; Richard Whish, *Competition Law*, 6th edn, Oxford University Press, New York, 2009, pp. 4-6.

The Korean economy, which is relatively smaller than other regimes, creates a complex trade-off amongst these three efficiencies.<sup>132</sup> When multiple goals are acknowledged, there can be confusion, and trade-offs should be made. However, it is not easy to know when or how to mix these various goals.<sup>133</sup> Although maximising economic efficiency or other social objectives may be touted by economists as the objective,<sup>134</sup> in practice it is not what policy-makers choose to pursue.<sup>135</sup> Therefore, establishing a goal or priority of multiple goals cannot be permanent, but rather should reflect a temporary consensus that is likely to change, according to changing political and economic realities.<sup>136</sup>

Korean competition law cannot, therefore, escape the political economy. The former KFTC chairman Professor Kwon argues that enforcement in Korea should aim at balancing several purposes such as (i) balanced economic growth<sup>137</sup> and distribution of wealth,<sup>138</sup> (ii) protection of SMEs and consumers,<sup>139</sup> and (iii) improvement of international trade.<sup>140</sup> Korean competition law and policy were established to harmonise these objectives based on the political economy.<sup>141</sup> This may be the influence of the Japanese AML, which observes that social and economic values of economic growth and democratic economy are best served by fair and free competition.<sup>142</sup> However, sometimes the balance or trade-off test seems very unclear, especially when lawyers contemplate the term, fairness. Protection of SMEs can be understood as the means of establishment of fair competition in exchange for dynamic

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<sup>132</sup> See Michal Gal, *Supra.*, note 6, pp. 42-3; Ohseung Kwon, *Supra.*, note 47, pp. 250-51. Kwon explains *Chaebol* contributes R&D investments for industrialisation, which may result in dynamic efficiency.

<sup>133</sup> See Albert Foer, 'The Goals of Antitrust: Thoughts on Consumer Welfare in the US' in Phillip Marsden (ed), *Handbook of Research in Trans-Atlantic Antitrust*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, pp. 583-6. The author argues that the primary goal of competition law is a market-based economic system in which competition should be the ruling principle, so long as it creates a reasonable balance of certain specified outcomes, which constitute the secondary goals. However, it does not seem to be implemented in Korea.

<sup>134</sup> See Richard Posner, *Antitrust Law*, 2nd edn, The University of Chicago Press, Chicago and London, 2001, p. 2.

<sup>135</sup> Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Supra.*, note 131, 2005, p. 10.

<sup>136</sup> Albert Foer, *Supra.*, note 133, p. 566.

<sup>137</sup> The concept of 'balanced economic growth' in the MRFTA can be compared with the language, 'public interest' in the AML. This concept is described as an interest of national economy as a whole. See Hiroshi Iyori and Akinori Uesugi, *Supra.*, note 26, pp. 49-50.

<sup>138</sup> Art. 123 Constitution.

<sup>139</sup> Arts. 32 and 124 Constitution.

<sup>140</sup> Arts. 125 and 127 Constitution. See Ohseung Kwon, *Supra.*, note 52, pp. 55-7. Competition and international trade policies have explicitly intersecting interests. See also Frederic Scherer, *Competition Policies for an Integrated World Economy*, Brookings Institute, Washington D.C., 1994, p. 43.

<sup>141</sup> Ohseung Kwon, *Supra.*, note 47, p. 62.

<sup>142</sup> Masako Wakui, *Supra.*, note 17, p. 40. This may be interpreted as the aim of economic growth by industrial policy in Japan and Korea.

efficiency by large firms in practice.<sup>143</sup> This hinders balance of efficiencies. The efficiency issue in Korea is, therefore, alternately powerful and weak. As argued by competition scholars, it is powerful because it is the minimum necessary condition of the ideal economic system's equilibrium, but weak because it is not the most important value in the society.<sup>144</sup>

### 2.3.3. Arguments for Modernisation

Korean competition law may have been used as a policy to achieve distributional objectives simultaneously whilst achieving greater social equity. This still remains controversial in Korea. Different governments give dissimilar weight to considerations of efficiency and equity when formulating their competition laws, depending on their political preferences.<sup>145</sup> Competition is an essential feature of the system for reasons both political and economic.<sup>146</sup> Korean competition law should be a form of government intervention that principally intends to increase economic efficiency in order to improve total economic welfare. It regulates excessive aggregation of market power *via* anti-competitive behaviours, ensuring that firms are continually subject to the discipline of competition.<sup>147</sup> There is one major reason why Korean competition law is still regarded as the main political feature to maximise total welfare. Although Korea achieved a high rate of economic growth, its market principles became unable to function properly.<sup>148</sup> Many believe this has not changed. After competition law legislation, the main competition policy has been revised to control the market dominance of *Chaebols* and reflect the interests of SMEs, because the government accepted public sentiment against *Chaebols* as a serious social issue.<sup>149</sup>

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<sup>143</sup> Constitutional Court of Korea, 96HunGa18, Dec. 26 1996. For further discussion, see also Young-Chul Lim, *Supra.*, note 119, p. 15.

<sup>144</sup> Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 18, p. 6.

<sup>145</sup> Sai Ree Yun, *Supra.*, note 70, p. 507; Martyn Taylor, *International Competition Law: A New Dimension for the WTO?*, Cambridge University Press, Cambridge, 2006, p. 24. Yun argues that there are 2 major goals in the Korean competition regime: (i) enhancing economic efficiency; and (ii) consumer welfare.

<sup>146</sup> See Anthony Ogus, *Regulation: Legal Form and Economic Theory*, Clarendon Press, Oxford, 1994, p. 22.

<sup>147</sup> Regulating market power is often considered beneficial. See Martyn Taylor, *Supra.*, note 145, p. 33. Whilst empirical evidence of the welfare benefits of competition law is difficult to obtain, some evidence suggests such benefits are significant.

<sup>148</sup> See Hojin Kang, 'The Development Experience of South Korea – The Role of Public Policy' in Poh-Kam Wong and Chee-Yuen Ng (eds), *Industrial Policy, Innovation and Economic Growth: The Experience of Japan and the Asian NIEs*, Singapore University Press, Singapore, 2001, pp. 343-4; Ohseung Kwon, *Supra.*, note 47, p. 77.

<sup>149</sup> Yong-Duk Jeon, *Supra.*, note 47, p. 3; Sai Ree Yun, *Supra.*, note 70, p. 508.

When production and distribution channels become dominated by them, competition can be harmed, and consumer welfare decreases. However, there are some arguments about an adequate approach to regulation on market concentration. Effective competition involves a mutual striving amongst comparable rivals, on the basis of competitive parity. Competitive parity should be thus regarded as fundamental for effective competition in the Korean market.<sup>150</sup> The current approach of the KFTC is, nonetheless, derived from the ideology that price control by a monopoly is harmful,<sup>151</sup> since it may result in loss of economic efficiency. Nevertheless, product quality and diversity should also be considered. It is unquestionable that society could potentially be better off if limitations were imposed on the operation of large firms or similar kinds of concentrated industry.<sup>152</sup>

The policy of protecting individual or SME competitors at the expense of competition and of large competitors is, however, not desirable if it results in inefficiency.<sup>153</sup> Since the law has focused mainly on competitive parity from the historical background of the *Chaebol* problem, the competition policy has also disregarded the meaning of competition law, as the means of protection of competition rather than competitors. The primary function of competition law should be to protect and promote pro-competitive conduct, rather than competitors.<sup>154</sup> This overall problem has come from a misunderstanding of the term ‘fairness’. It has been generally understood that free competition refers to protection of competition, and fair competition means protection of fairness in business practices, which can be also understood as protection of competitors.<sup>155</sup> The KFTC has faced the dilemma of choosing whether the law should protect competition or competitors. This problem is often observed in the case of vertical restraints.

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<sup>150</sup> For further discussion about competitive parity, see William Shepherd, ‘Section 2 and the Problem of Market Dominance’ in Theodore Kovaleff (ed), *The Antitrust Impulse: An Economic, Historical, and Legal Analysis Vol. II.*, M.E. Sharpe, New York, 1994, pp. 1007-8.

<sup>151</sup> This price control by monopolists, first described by Adam Smith, seems the major fear of the Korean authority. For further illustration, see Adam Smith, *The Wealth of Nations*, reprinted, Clarendon Press, Oxford, 1976, Book I, Chapter 7, paras. 26-8.

<sup>152</sup> Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Supra.*, note 131, p. 5.

<sup>153</sup> E.g., the orthodox Chicago approach criticises the policy of protection of SMEs in expense of large competitors. See Roger Van den Bergh and Peter Camesasca, *Supra.*, note 131, p. 47.

<sup>154</sup> See Donald Turner, ‘The Durability, Relevance, and Future of American Antitrust Policy’, *California Law Review*, Vol. 75, No. 3, 1987, p. 798.

<sup>155</sup> For further discussion about the meaning of free and fair competition, see also Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 84, p. 32.

## 2.4. Problems of Vertical Restraints: Market Power and Trade Barriers in Korea and Japan

### 2.4.1. Foreclosure of Vertical Restraint as Private Trade Barrier

Firms such as *Chaebols* may rely on vertical arrangements to overcome some trade policy provisions. For example, a firm's vertical control over the distribution system can allow it to prevent foreign competitors from penetrating the domestic market. This includes foreclosing access to distribution channels, refusal to deal, and control of access to essential facilities. Markets will be less contestable or competitive if domestic distribution channels are restricted.<sup>156</sup> Such barriers will be a substantial deterrent to foreign firms, especially if there are significant costs of setting up a distribution channel.<sup>157</sup> Vertical foreclosure to foreign firms can be a strategic method of *Chaebols*. This could be comparable to vertical *Keiretsu* in Japan. The sale system through vertical *Keiretsu* grew in the late 1950s. They formalised a system in which their products were carried almost exclusively by distributors under their control. Large firms also provided affiliated retail stores with something more valuable than money.<sup>158</sup> Since these firms controlled their own retailing networks, they could also control prices and profit margins. Through their distribution, the large firms closed the market and protected it from penetration by domestic rivals and foreign competitors alike.<sup>159</sup> Because the number of market entrants was essentially fixed, competition amongst *Keiretsu* came to centre on (i) increasing the quality and improving the features of products to steadily improve public images and (ii) developing larger distribution networks.<sup>160</sup>

Although the *Chaebol* system is different from vertical *Keiretsu*, its strategy may be considered as similar to the *Keiretsu*. Since *Chaebols* normally have diversified structure, whether horizontal or vertical, they may have foreclosed the domestic market not only against

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<sup>156</sup> Contestability theory in this circumstance focuses increased attention on entry barriers. See William Baumol, 'Contestable Markets: An Uprising in the Theory of Industry Structure', *The American Economic Review*, Vol. 72, No. 1, 1982, pp. 3-4; Elizabeth Bailey and William Baumol, 'Deregulation and the Theory of Contestable Markets', *Yale Journal of Regulation*, Vol. 1, 1984, p. 111.

<sup>157</sup> See Erlinda Medalla, 'Perspectives on Competition Policy: an Overview of the Issues' in Erlinda Medalla (ed), *Competition Policy in East Asia*, Routledge, London and New York, 2005, p. 6.

<sup>158</sup> See Kenichi Miyashita and David Russell, *Supra.*, note 27, pp. 122-3.

<sup>159</sup> See René Belderbos and Peter Holmes, 'An Economic Analysis of Matsushita Revisited', *The Antitrust Bulletin*, Vol. 40, 1995, pp. 828-30; Frederic Scherer, 'Retail Distribution Channel Barriers to International Trade', *Antitrust Law Journal*, Vol. 67, 1999, pp. 94-5. Strategic practices in international market could be also observed in the US case, *Matsushita Electric Industrial Co., Ltd. V. Zenith Radio Corporation*, 475 US 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

<sup>160</sup> Kenichi Miyashita and David Russell, *Supra.*, note 27, pp. 124-5.

foreign firms, but also domestic SMEs. This brought the attention of the competition policy-makers. The fear of largeness in the Korean market takes shape in stringent implementation of law and policy on vertical arrangements. The KFTC has viewed monopolistic tendencies as deeply rooted, surviving from the open market, and as something that could be redressed only with active policies to counteract the *Chaebols*' market dominance. It reasons that, even under liberalised trade, there is always the possibility that importers and producers can collude to control the price of products and keep them high at the expense of the consumer<sup>161</sup> when the market is vertically foreclosed. This thought lingers as long as the KFTC's concerns about the market concentration fade away.

There are, however, some arguments against this competition policy. In particular, since the late 1990s, there has been a significant change in the competition environment. Some commentators argue that only controlling the concentrated domestic market is not favourable for the state economy, because this curbs large enterprises from expanding their businesses abroad.<sup>162</sup> In fact, the KFTC is mistakenly applying discriminatory rules against *Chaebols*, although their threat in the vertical level is less than before. Vertical control by large firms in Korea and Japan has a long history and influenced competition. Competition laws in major countries generally have not, however, succeeded in establishing a clear standard towards vertical cases. Their standards are at an evolutionary stage. Standards regarding vertical restraints in Korean and Japanese competition laws are, in particular, less clear than in the US and the EC. Lack of clearness emanates from the cover-all-case provision, the Korean and Japanese UBP clauses whose coverage extends beyond vertical arrangements.<sup>163</sup>

#### 2.4.2. Global Aspects of Korean Competition Law

The problem of lack of globalised competition in Korea originates from the long-established market intervention of the state, which caused the emergence and expansion of the monopolistic market. As a result, it is widely thought that Korean competition policy should focus on eliminating economic concentration, especially regarding two major problems: (i)

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<sup>161</sup> Tat Yan Kong, *Supra.*, note 14, pp. 174-5.

<sup>162</sup> Nam-Kee Lee, (Competition Policy in 2002), *Supra.*, note 76, pp. 38-9.

<sup>163</sup> See Toshiaki Takigawa, 'Prospect of Antitrust Law and Policy in 21st Century: In Reference to Japanese Antimonopoly Law and Fair Trade Commission' *Journal of Korean Competition Law*, Vol. 8, 2002, p. 170.

*Chaebols'* significant economic concentration, itself, which can be used as a private power, so-called *Il-ban-jib-jung* (general concentration); and (ii) *Chaebols'* market power, that may impede market function, called *Si-jang-jib-jung* (market concentration).<sup>164</sup> It is thus not surprising that current competition policy focuses intensively on restricting market power from the fear of further economic concentration, which influenced politics and the economy.<sup>165</sup>

Each competition regime has a different set of ideas on vertical restraints. This can come from the market disciplines during the time of economic development-priority. The dominant-firm setting through vertical integration in Korea and Japan involves a steep variation in competitive pressure. The SMEs must endure extreme degrees of risk, whilst the dominant firm faces only light pressure. Competition can then be unbalanced and weak.<sup>166</sup> Competition law study has, nevertheless, changed how people think about this problem. One major consideration is not simply how large a firm is, or what its market influence is, but whether there is a possible market entry. The behaviour of a monopolist can be influenced by the number of entrants.<sup>167</sup> Nevertheless, the common objectives for competition laws in Korea and Japan, in reality, focus on the following: (i) fairness to preserve a society for SMEs; (ii) fairness to all market entities; and (iii) a selective fairness rule to regulate dominance<sup>168</sup> rather than vigorous foreign competition. The advent of globalisation has, however, forced economies to recognise that trade and competition issues are not only important, but inseparable. They are not substitutes but complementary. If there is a fundamental characteristic of globalisation, it is the competition for growth. It is the race to be succeed that drives firms to make new products, technologies, and into the new markets, facing new rivals and competitive pressures.<sup>169</sup>

In other words, globalisation along the lines of competition policy represents a generally pro-competitive process, because new competitors emerge. This effect implies a

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<sup>164</sup> See Ohseung Kwon, 'Gong-Jung-Go-Rae-Bub-Ui-Kae-Yo-Wa-Jaeng-Jum (Issues and Arguments in the Monopoly Regulation and Fair Trade Act)' in Ohseung Kwon (ed), *Gong-Jung-Go-Rae-Wa-Bub-Chi [Fair Trade and Regulation]*, Bubmunsa, Seoul, 2004, pp. 17-8.

<sup>165</sup> Ohseung Kwon, *Supra.*, note 47, p. 37.

<sup>166</sup> William Shepherd, *Supra.*, note 150, p. 1011.

<sup>167</sup> Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Supra.*, note 131, p. 5.

<sup>168</sup> For further discussion regarding fairness in competition law, see Eleanor Fox, 'The Kaleidoscope of Antitrust and Its Significance in the World Economy: Respecting Differences' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Corporate Law 2002*, Juris Publishing, Huntington NY, USA, 2002, pp. 598-9.

<sup>169</sup> David Round, *Supra.*, note 8, pp. 249-51.



changing situation for incumbent large enterprises such as *Chaebols*. They face new challenges and opportunities, driven by globalisation. On the one hand, they may lose their market positions. On the other hand, globalisation offers opportunities to internationalise their activities and improve their competitive profits.<sup>170</sup> The elimination of barriers to international trade is a powerful instrument in promoting competition and efficient market functioning. Thus, domestic competition law is important. The potential benefits of market-opening measures cannot be achieved unless countries take steps to prohibit anti-competitive practices and structural barriers, such as private monopolies and restrictions on entry.<sup>171</sup> Therefore, although competition law represents a method to protect competition, it can be misused strategically to allow domestic enterprises to restrict competition in the domestic market. A strategic competition policy is, thus, an analogue to ‘strategic trade policy’, treating competition law in a discriminatory way, causing an anti-competitive impact in domestic and global markets.<sup>172</sup>

In Korea, however, the circumstances are different from this point of view. Korean competition law was legislated in order to prohibit the problems of market concentration, especially large business groups which had influenced the economy and the market. Therefore, the aims of Korean competition law are so radical as to prevent anti-competitive or unfair behaviour of domestic large firms. It has not discriminated against foreign firms but against *Chaebols*. It is not difficult to obtain a consensus for having competition law in Korea. Korea has not been blamed for regarding globalisation along with competition law as a means of strategic legislation for trade. This is different from the Japanese case.<sup>173</sup> When explaining the success of Japanese firms in export markets, commentators often mention the advantage of a protected domestic market. Whilst charging high prices in the domestic market, Japanese

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<sup>170</sup> See Oliver Budzinski, *The Governance of Global Competition: Competence Allocation in International Competition Policy*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2008, p. 13.

<sup>171</sup> See Frédéric Jenny, ‘Globalization, Competition and Trade Policy: Convergence, Divergence and Cooperation’ in Clifford Jones and Mitsuo Matsushita (eds), *Competition Policy in the Global Trading System*, Kluwer Law International, The Hague, 2002, p. 305; Robert Anderson and Frédéric Jenny, *Supra.*, note 7, p. 72. International trade and competition policies are complementary because whereas international trade policy eliminates public barriers to trade, competition policy can eliminate private restraints which could defeat the objective of market access.

<sup>172</sup> Oliver Budzinski, *Supra.*, note 170, pp. 53-4.

<sup>173</sup> See Mark Tilton, *Restrained Trade: Cartels in Japan’s Basic Materials Industries*, Cornell University Press, Ithaca NY, USA and London, 1996, pp. 27-8. The Japanese government has a long history of actively encouraging and administering cartels. In particular, in the 1980s the government became more optimistic about economic growth and less concerned about excessive competition. Most trade associations engaged in cartels that the government actively helped set up.

firms could penetrate foreign markets with low-priced products.<sup>174</sup> Consequently, through the leverage strategy, they could foreclose the domestic market, and vertical *Keiretsu* were the centre of this strategy.<sup>175</sup> Japanese competition enforcement regarded as a strategic trade policy.

The KFTC, however, actively works in its enforcement. It is time then to move on to the next step which a mature economy should consider. It needs to examine whether the current law is so strict as to create an inefficient market environment in Korea. Understanding competition law in Korea should be, thus, not only about prohibiting large firms in legislation and judicial decisions, but also about understanding particular theories that can influence the direction of competition policy, since the purpose of laws can change over time. Its objective should not only be protection of consumers or SMEs. The KFTC has to examine whether the further step of liberalising the law on large firms may create artificial private barriers in vertical level. Market-entry barriers can be erected by a monopolist through combining distribution systems, or requiring financially linked buyers to refuse to deal with foreign sources of supply. However, although a sound presumption of market dominance is a controversial issue, firms without monopoly power imposing vertical restraints are likely to be acting for efficiency rather than from anti-competitive purposes.<sup>176</sup> Liberal trade under Free Trade Agreements (FTA) with large economies will reduce the problems of private barriers, therefore creating an open market.<sup>177</sup> The KFTC can then adopt more lenient rules of vertical restraints where there is no expectation of harm from them.

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<sup>174</sup> See Paul Krugman, 'Import Protection as Export Promotion: International Competition in the Presence of Oligopoly and Economics of Scale' in Henry Kierzkowski (ed), *Monopolistic Competition and International Trade*, Clarendon Press, Oxford, 1984, p. 180. Firms with a secure domestic market have a number of advantages. They are assured of the economies of large scale production, selling enough over time to move down the learning curve, and earning enough to recover the costs of R&D.

<sup>175</sup> For further discussion, see Sylvia Ostry, 'Globalization, Domestic Policies and The Need For Harmonization' in Leonard Waverman, William Comanor, and Akira Goto (eds), *Competition Policy in the Global Economy: Modalities For Competition*, Routledge, New York, 1997, pp. 35-6.

<sup>176</sup> See Eleanor Fox and Janusz Ordover, 'The Harmonization of Competition and Trade Law: The Case for Modest Linkages of Law and The Limits to Parochial State Action' in Leonard Waverman, William Comanor and Akira Goto (eds), *Competition Policy in The Global Economy: Modalities for Cooperation*, Routledge, London and New York, 1997, pp. 420-21.

<sup>177</sup> The KFTC seems to recognise the impact of the FTA on the Korean market although it does not fully consider its policy change according to this. A number of publications regarding FTA are on the KFTC website in Korean: [www.ftc.go.kr/news/fta/fatalist.jsp](http://www.ftc.go.kr/news/fta/fatalist.jsp) (accessed 10 Mar. 2009).

## 2.5. Concluding Remarks

This chapter attempted to highlight the issues and criticisms raised regarding the development of the Korean economy and competition law. In particular, it sketched out the market structure and approaches of the authorities, dealing with complex issues such as market concentration and competition policy for market access. Pro-competitive systems provide important checks and balances on monopoly power. Monopoly power is often seen as a correlation with politics. Open and competitive market systems are, therefore, commonly considered as a result of democracy.<sup>178</sup> *Chaebols* may mean the side effects of macroeconomic achievements. If they continue to improve their competitiveness in foreign markets, this may improve state economic development. However, when their domestic market power is unnecessarily large, the risk of state economy failure can increase. Therefore, the authorities have sought to reduce the negative effects from business groups' activities<sup>179</sup> rather than focusing on positive consequences from them.

The KFTC has doubled its efforts to make the domestic market structure even more transparent and competitive, through controlling *Chaebols*. It went further, to amend *Chaebol*-dominated monopolistic or oligopolistic structure, redressing abuses of market dominance. However, faced with the current trends of deepening interdependency and integration of the world economy, the KFTC has an assignment of further strengthening its competition advocacy task to create an open economy. To that end, the KFTC has strenuously tried to redress competition law, carry out regulatory reforms, and introduce competition from overseas,<sup>180</sup> without a full consideration of the market economy principle.<sup>181</sup> Korean competition law and policy, which are discriminatory against domestic

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<sup>178</sup> See Thomas Jorde and David Teece, 'Innovation, Market Structure and Antitrust: Harmonizing Competition Policy in Regimes of Rapid Technological Change' in Leonard Waverman, William Comanor, and Akira Goto (eds), *Competition Policy in the Global Economy: Modelities For Competition*, Routledge, New York, 1997, p. 290.

<sup>179</sup> See Dong-Won Suh, 'Dae-Ki-Up-Jib-Dan-Ae-Dae-Han-Kyu-Jae (Regulations on Big Business Groups)' in Ohseung Kwon (ed), *Gong-Jung-Go-Rae-Wa-Bub-Chi [Fair Trade and Regulation]*, Bubmunsa, Seoul, 2004, p. 313.

<sup>180</sup> Soon-Sik Ju, *Supra.*, note 108, p. 184.

<sup>181</sup> There is a dispute about the market economy system in Korea. Some scholars argue that the Korean market system is a 'social market economy' or '*Sa-Hwe-Cho-Wha-Jok-Si-Jang-Kyoung-Jae* (socially harmonised market economy)' as held by the Constitutional Court of Korea judgment 2001Heonma132, June 28, 2001. This is named after the German idea, '*Soziale Marktwirtschaft*', which was developed under *Ordoliberalism* of the Freiburg School. See Ohseung Kwon, *Supra.*, note 47, pp. 43-55; Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 84, pp. 6-7.

business groups, may harm the economy and competition in Korea, and commentators have criticised this policy.<sup>182</sup>

Unlike many Asian countries, Korea has not received external pressure, or even direct intervention from foreign countries, to trigger the introduction of competition policy. Although there were no significant pressures or intervention from foreign powers, the authority created a competition policy for the reason of internal pressure and desires for prohibition of economic power, and fair shares for consumers and SMEs. There has been concern amongst developing countries that competition policy may adversely affect economic growth by imposing restrictions on the size of domestic firms. Some scholars hold the view that competition policy should be implemented only after economic growth is achieved. The Japanese success of creating a miracle economy might support this argument that industrial policy should come before competition policy.<sup>183</sup> Competition policy is sometimes assessed not just on a law-alone basis but also on how it integrates with other aspects of industrial policy.<sup>184</sup>

Competition law is an indispensable element of a modern market system.<sup>185</sup> As the economy matures, Korean policy-makers should be more conscious of the need to promote economic efficiency in its economy. The pro-competition legislative instruments, together with aggressive enforcement policy, have been in evidence during the last several years.<sup>186</sup> However, there is still a dilemma in the MRFTA provisions of vertical restraints (hereafter, vertical regulation). If the Korean competition authority had a less strict vertical regulation, it would harm international trade. In contrast, if it keeps a strict measure in application of law to efficient vertical practices, it might prevent pro-competitive outcomes and efficiency. Thus, it creates the assignments of providing a sound regulation of vertical restraints in order to trade-off the positive and negative effects of vertical practices. This issue should bring more

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<sup>182</sup> See Sung-Hee Jwa, 'The Way to Save the Korean Economy from the Trap' in Sung-Hee Jwa (ed), *Thoughts of Amendment of the Monopoly Regulation and Fair Trade Act*, Korea Economy Research Institute, Seoul, 2004, pp. 33-7.

<sup>183</sup> See William Tabb, *The Postwar Japanese System: Cultural Economy and Economic Transformation*, Oxford University Press, New York and Oxford, 1995, p. 37.

<sup>184</sup> Thomas Jorde and David Teece, *Supra.*, note 178, pp. 298-9.

<sup>185</sup> Ping Lin, *Supra.*, note 3, p. 35.

<sup>186</sup> Sung-Hee Jwa, *Supra.*, note 19, p. 46; Mark Williams, *Competition Policy and Law in China, Hong Kong and Taiwan*, Cambridge University Press, Cambridge, 2005, pp. 30-31.

attention to the KFTC, and economic theories and comparative studies can give the benefits of better solutions, which will be discussed in the next chapter.

## Chapter 3

# Economics and Comparative Competition Laws of Vertical Restraints

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### 3.1. Fundamental Issues in Vertical Relations

Vertical relations (integration and restraints) are at the heart of the economic system worldwide.<sup>1</sup> Some of them may be regarded as anti-competitive at first glance, where they can limit the choices of buyers. However, they can also turn out to be non-detrimental to competition, through close examination of economics. Therefore, it is necessary to scrutinise economic theories that have widely influenced vertical regulations, and also individual regimes' applications of these theories, to gain mutual understanding. The previous chapter reviewed laws regarding vertical relations in Korea in the wider macroeconomic context. This chapter focuses broadly on the subjects of vertical relation at a microeconomic level, and through a comparative study. In this chapter, some questions will be posed such as: (i) what interests are affected by the development of economic theories, especially suitable for the Korean market; and (ii) what other regimes' approaches to vertical restraints are. These are crucial to properly develop the legal techniques of the Korea Fair Trade Commission (KFTC). The former part will be explained through theoretical arguments in two major schools in competition policy, Harvard and Chicago, although Post-Chicago theoretical developments are not ignored. The latter issue will be made through comparative research of the US, the EC and Japan. In particular, the historical development in the US and the EC will be separately discussed, and the Japanese law will be discussed by the comparison with the Monopoly Regulation and Fair Trade Act (MRFTA). Because of the similarity between the Korean and Japanese laws, a close comparison can be beneficial.

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<sup>1</sup> See Maurizio Gambardella and Francesco Salerno, 'Vertical Agreements: Was the Commission's Response Adequate? On the Commission's Ability to Reform Long-standing Policies' in Giuliano Amato and Claus-Dieter Ehlermann (eds), *EC Competition Law: A Critical Assessment*, Hart Publishing, Oxford and Portland, USA, 2007, p. 176.

A comparative study from historical development will demonstrate how competition authorities' views on vertical relations have changed. For example, a few decades ago, almost all vertical restraints were regarded as anti-competitive in the US courts. However, nowadays, all vertical restraints benefit from the rule of reason.<sup>2</sup> Most competition authorities accept that vertical restraints without market power can make markets more efficient by benefiting consumers, despite possible anti-competitive effects. Their task is, therefore, how to achieve a trade-off of efficiency gains and anti-competitive losses in vertical cases. The assignment which the KFTC and the courts face is how to decide whether particular types of vertical restraints possibly promote economic efficiency without significant anti-competitive outcomes. This topic has been a subject of extreme argument. Despite difficulties in solving this question, current economic studies have introduced various solutions.

In particular, the Chicago School, in the mainstream of competition policy, maintains that vertical integration and restraint are not the sole reasons for abuse of dominant positions in up- and downstream levels (or manufacturing and distributing).<sup>3</sup> According to the Chicago scholars, these practices are efficient and do not lower total welfare,<sup>4</sup> due to no monopoly reason for vertical control.<sup>5</sup> According to the Post-Chicago scholars,<sup>6</sup> however, vertical restraints may have anti-competitive effects. For example, in some cases which depend on the number of firms in the market,<sup>7</sup> vertical integration leaves the remaining upstream firm in a position of market power *vis-à-vis* the remaining downstream firm. The non-integrated upstream firm may have no incentive to compete aggressively with the integrated firm, in

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<sup>2</sup> The rule of reason test was first introduced in the US, e.g., *Standard Oil Co. of New Jersey v. United States* 221 US 1 (1911). See most recently, *Leegin Creative Leather Products, Inc. v. PSKs, Inc.*, 551 US (2007).

<sup>3</sup> See Robert Bork, 'Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception', *The University of Chicago Law Review*, Vol. 22, No. 1, 1954, pp. 194-201.

<sup>4</sup> See Robert Bork and Ward Bowman, Jr., 'The Crisis in Antitrust', *Columbia Law Review*, Vol. 65, No. 3, 1965, p. 370; Robert Bork, *The Antitrust Paradox: A Policy at War with Itself*, The Free Press, New York, 1993, p. 226; Robert Hahn (ed), *Antitrust Policy and Vertical Restraints*, AEI, Washington D.C., 2006, p. 3.

<sup>5</sup> This is often explained as the improvement of aggregate welfare. For further discussion, see Jean Tirole, *The Theory of Industrial Organization*, The MIT Press, MA, USA, 1989, pp. 169-70.

<sup>6</sup> See William Kovacic and Carl Shapiro, 'Antitrust Policy: A Century of Economic and Legal Thinking', *The Journal of Economic Perspectives*, Vol. 14, No. 1, 2000, pp. 55-8; Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Economics of Regulation and Antitrust*, 4th edn, The MIT Press, Cambridge MA, USA and London, 2005, pp. 234-6. Utilising game theory, the theories of the Post-Chicago School have been developed since the 1980s. This has shown that the conclusions of the Chicago School are plausible but only in certain cases. Under more general conditions, vertical restraints, such as tying, exclusive dealing, and predatory pricing, can be both profitable to incumbents and also welfare-reducing.

<sup>7</sup> See Martin Perry, 'Vertical Integration: Determinants and Effects' in Richard Schmalensee and Robert Willig (eds), *Handbook of Industrial Organization, Vol. I*, Elsevier Science Publisher B.V., Amsterdam, 1989, p. 200. This is important because ease of access or the diversity in the choice amongst retailers affect consumer welfare.

which case it may choose to align its prices to the vertically integrated firm. This can lead to anti-competitive effects.<sup>8</sup> Overall, this demonstrates that US antitrust law has seldom suffered from a shortage of economic theories. These schools' debates suggest whether and why certain behaviour should be unlawful.<sup>9</sup> The US conclusions from economics can thus give the KFTC and the courts better legal techniques.

Nevertheless, there have been many changes of competition authorities' and courts' views worldwide, and this topic has remained one of the hardest for Korea. It seems that academic literature on competition law and economics has offered little guidance for the KFTC to achieve a proper assessment of vertical relations in practice. When challenges under law have involved vertical restraints, the KFTC and the courts often seem to lose their ways in economic theories. This is certainly because of the experience of total monopoly by *Chaebols*, which has influenced economy and competition policy. The KFTC understands how vertical relations, under specific circumstances and market structure, are likely to distort competition rather than improve competition or efficiency. Besides, the courts have tried to examine suitable measures of competition law, to only prohibit vertical practices that are expected to do harm, whilst leaving other beneficial practices.<sup>10</sup> However, the issue of economics' appropriate role in Korean competition law evokes two questions: (i) what kind of economic theories (if any) Korean competition policy should use; and (ii) whether economic efficiency should be the major goal of competition law.<sup>11</sup> Therefore, when discussing vertical restraints, it is helpful to begin with an overview of economic arguments

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<sup>8</sup> See Janusz Ordover, Garth Saloner and Steven Salop, 'Equilibrium Vertical Foreclosure' *The American Economic Review*, Vol. 80, 1990, p. 127; Giorgio Monti, *EC Competition Law*, Cambridge University Press, Cambridge, 2007, p. 71. Such as raising barriers to entry and vertical or margin squeezes can also bring anti-competitive results. See also William Shepherd, *The Economics of Industrial Organization*, 3rd edn, Prentice Hall, Englewood NJ, USA, 1990, pp. 366-8; Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 82 EC*, Hart Publishing, Oxford and Portland, USA, 2006, pp. 304-7.

<sup>9</sup> For general discussion about economic views, see Herbert Hovenkamp, 'The Reckoning of Post-Chicago Antitrust' in Antonio Cucinotta, Roberto Pardolessi and Roger Van den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, p. 1; Lawrence Sullivan and Warren Grimes, *The Law of Antitrust: An Integrated Handbook*, 2nd edn, Thomson West, St. Paul MINN, USA, 2006, pp. 318-23.

<sup>10</sup> Vertical restraints pose competition law issues of two kinds: (i) price may be adversely affected; and (ii) the condition entry may be impaired. See Oliver Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications: A Study in the Economics of Internal Organization*, The Free Press, New York, 1975, p. 115.

<sup>11</sup> These are not the issue only in Korea. See Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, 3rd edn, Thomson West, St. Paul, MINN, USA, 2005, p. 71; Luc Peeperkorn and Vincent Verouden, 'The Economics of Competition' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, Oxford University Press, Oxford, 2007, p. 4.



regarding pro- and anti-competitive effects. This chapter presents some basic reminders of economics before moving on to a comparative study.

### 3.2. Arguments of Economic Theories of Vertical Relations

#### 3.2.1. Chicago School vs. Harvard School in Theory Debates<sup>12</sup>

The Chicago School has offered competition law diverse views that few legal disciplines ever attained. Its fundamental principles are: (i) markets are extremely robust and competitive outcomes are highly likely to emerge without any significant governmental intervention; and (ii) competition authorities are imperfect decision makers.<sup>13</sup> In particular, by using simple price theoretical or monopoly models, the Chicago School has argued that the traditional concern in vertical restraints is illogical. Rational firms would not engage in vertical practice for anti-competitive reasons. They also suggest efficiency-enhancing reasons for vertical restraints.<sup>14</sup> According to them, vertical practices can increase production and distribution, and also minimise transaction costs from uncertainty in supply or over consumer demand.<sup>15</sup> The main assertion is that a supplier is willing to impose vertical restraints only where the restraints can increase sales and promote inter-brand competition, based on the free-riding

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<sup>12</sup> Much of the current debate in competition policy has been amongst three groups: (i) Harvard, (ii) Chicago, and (iii) Post-Chicago schools. Whilst these schools' thoughts have diverse origins and historically different ideas about the complexity of the economy and the appropriate role of government, they have also converged on a number of important points. For further discussion, see Rudolph Peritz, *Competition Policy in America: History, Rhetoric, Law*, Oxford University Press, New York, 1996, pp. 182-7; Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution*, Harvard University Press, Cambridge MA, USA and London, 2005, pp. 32-9; Lawrence Sullivan and Warren Grimes, *Supra.*, note 9, p. 9.

<sup>13</sup> See Richard Posner, 'The Chicago School of Antitrust Analysis', *University of Pennsylvania Law Review*, Vol. 127, No. 4, 1979, p. 928. According to Posner, Director formulated this key of the Chicago School and it was conservative antipathy to the government intervention. See also Aaron Director and Edward Levi, 'Law and the Future: Trade Regulation', *Northwestern University Law Review*, Vol. 51, No. 1, 1956, pp. 281-96.

<sup>14</sup> For further description about the Chicago School's propositions, see Herbert Hovenkamp, 'Antitrust Policy After Chicago' *Michigan Law Review*, Vol. 94, 1985, p. 213; Herbert Hovenkamp, *Supra.*, note 9, p. 4; Herbert Hovenkamp, *Supra.*, note 11, pp. 62-4; Michael Whinston, *Lectures on Antitrust Economics*, The MIT Press, Cambridge MA, USA and London, 2006, p. 134.

<sup>15</sup> See Kenneth Arrow, 'Vertical Integration and Communication', *The Bell Journal of Economics*, Vol. 6, No. 1, 1975, p. 173; Raymond Deneckere, Howard Marvel, and James Peck, 'Demand Uncertainty, Inventories, and Resale Price Maintenance', *The Quarterly Journal of Economics*, Vol. 111, No. 3, 1996, pp. 885-9; Raymond Deneckere, Howard Marvel, and James Peck, 'Demand Uncertainty and Price Maintenance: Markdown as Destructive Competition', *The American Economic Review*, Vol. 87, No. 4, 1997, pp. 634-5.

justification.<sup>16</sup> In the absence of vertical restraints, distributors are unwilling to pay the cost of pre-sale services because other distributors will be able to take free-riding on its service investment.<sup>17</sup>

In particular, Telser argues that this free-riding problem plays a fundamental role in explaining the need of vertical restraints such as minimum Resale Price Maintenance (RPM). An increase in pre-sale services as the result of RPM can enhance the value of products to consumers and increase demand. This can help to recoup the fixed cost of the investment. If there is no vertical restraint, consumers are willing to buy the products from the distributors that provide less service, with a lower price, so as not to pay the pre-sale service charge.<sup>18</sup> Without RPM, the higher-cost distributors would not be willing to sell the products, because the dealer margins would be too low for profitability.<sup>19</sup> Suppliers may thus have incentives of imposing vertical restraints such as exclusive dealing, territorial restrictions, or RPM on distributors to prevent this negative externality.<sup>20</sup> This debate has been extended to products for which a distributor offers quality certification,<sup>21</sup> especially in the luxury product markets.<sup>22</sup> The theory describes how a certain distributor that carries the luxury product signals it is of high quality. Prominent distributors are willing to set up high reputations for luxurious and distinctive items. Such a distributor is willing to engage its brand reputation by selling a given product only if the product is sufficiently rewarding, and not carried by cheap discount distributors. Vertical restraint is therefore one method of persuading consumers not

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<sup>16</sup> See Alison Jones and Brenda Sufrin, *EC Competition Law: Text, Cases, and Materials*, 2nd edn, Oxford University Press, New York, 2004, p. 604; Herbert Hovenkamp, *Supra.*, note 12, p. 185; Mark Furse, *Competition Law of the EC and UK*, 6th edn, Oxford University Press, Oxford, 2008, p. 183.

<sup>17</sup> However, whether restraints will induce retailers to incur the cost of providing pre-sale service is somewhat uncertain. See Alden Abbot, 'Paradox Regained: Towards a "New Economic Approach" to Vertical Restraints Policy', *George Washington Law Review*, Vol. 48, 1980, pp. 575-6.

<sup>18</sup> See Lester Telser, 'Why Should Manufacturers Want Fair Trade?', *Journal of Law and Economics*, Vol. 3, 1960, pp. 86-90.

<sup>19</sup> See Pauline Ippolito and Thomas Overstreet, Jr., 'Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case against the Corning Glass Works', *Journal of Law and Economics*, Vol. 39, No. 1, 1996, p. 325.

<sup>20</sup> Jean Tirole, *Supra.*, note 5, p. 173; Herbert Hovenkamp, *Supra.*, note 12, pp. 184-5.

<sup>21</sup> See Benjamin Klein, 'Transaction Cost Determinants of "Unfair" Contractual Arrangements', *The American Economic Review*, Vol. 70, No. 2, 1980, pp. 360-61.

<sup>22</sup> This argument is most persuasive when a manufacturer invests resources to create a product image of quality where price reductions may actually reduce sales volume. Some suppliers dislike seeing their product used as a 'loss leader' to induce customers to come into a store and stay to buy other products. See Russell Warren, *Antitrust in Theory and Practice*, Grid, Columbus Ohio, USA, 1975, p. 154; Andy Chen and Keith Hylton, 'Procompetitive Theories of Vertical Control', *Hastings Law Journal*, Vol. 50, 1999, pp. 604-6; Phillip Areeda and Herbert Hovenkamp, *Fundamentals of Antitrust Law, Vol. II*, Aspen Law & Business, New York and Gaithersburg, USA, 2002, pp. 592-3; Robert Pitofsky, Harvey Goldschmid, and Diane Wood, *Trade Regulation: Cases and Materials*, 5th edn, Thomson West, New York, 2003, p. 623.

to purchase from a discount store.<sup>23</sup> Consequently, the focus of competition law should not be on vertical restraints but on horizontal cartels and mergers.<sup>24</sup> For this reason, free-riding and efficiency justifications have been popular theories, and given attention by lawyers and economists for a long time.<sup>25</sup> These arguments have influenced competition policies on vertical restraints worldwide, which started in the US courts. However, it seems that the Chicago School economic theory is not always the best, and certainly not the only analytical tool.<sup>26</sup>

Some commentators from Harvard have argued that vertical practices should not be allowed unless these restraints bring greater efficiency, because exclusionary restraints will harm consumers where a supplier has significant market power.<sup>27</sup> In particular, they assert that the free-riding or efficiency justification does not sufficiently provide empirical evidence of which vertical restraints encourage distributors to afford more pre-sale services.<sup>28</sup> Hence, it is uncertain whether, through vertical restraints, distributors will have the incentive to provide pre-sale services that suppliers expect. Distributors with restraints may only enjoy the high margins without providing the services.<sup>29</sup> In particular, Comanor criticises the free-riding theory.<sup>30</sup> He argues that the Chicago School's theory fails to consider different preferences of consumers for distributors' extra pre-sale services. The Chicagoans' theory does not distinguish between marginal and infra-marginal consumers. Consumer welfare loss and gain through changing products depend on the preferences of all consumers, and general consumers' interest is not considered in the Chicagoans' justification. The alterations do not

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<sup>23</sup> Jean Tirole, *Supra.*, note 5, pp. 182-4.

<sup>24</sup> See Richard Posner, 'The Chicago School of Antitrust Analysis' in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, pp. 195-6.

<sup>25</sup> See Richard Posner, *Antitrust Law*, 2nd edn, The University of Chicago Press, Chicago, 2001, pp. 172-3. Vertical restraints may even promote market entry. For instance, a pioneer dealer may fear that the manufacturer will designate other dealers before he recovers his investment in developing the market for that brand. Without restraints, a new manufacturer may find no dealers willing to make the pioneering investment and may thus be dissuaded from entry. See also Phillip Areeda and Herbert Hovenkamp, *Supra.*, note 22, p. 597.

<sup>26</sup> Herbert Hovenkamp, *Supra.*, note 9, p. 5.

<sup>27</sup> See Joseph Brodley, 'Post-Chicago Economics and Workable Legal Policy', *Antitrust Law Journal*, Vol. 63, 1995, p. 689; Valentine Korah and Denis O'Sullivan, *Distribution Agreements Under the EC Competition Rules*, Hart Publishing, Oxford, 2000, p. 2.

<sup>28</sup> See William Bohling, 'A Simplified Rule of Reason for Vertical Restraints: Integrating Social Goals, Economic Analysis, and Sylvania', *Iowa Law Review*, Vol. 64, 1979, pp. 474-5.

<sup>29</sup> See Benjamin Klein and Kevin Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms', *Journal of Law and Economics*, Vol. 31, 1988, p. 265; David Butz and Andrew Kleit, 'Are Vertical Restraints Pro or Anticompetitive? Lessons from Interstate Circuit', *Journal of Law and Economics*, Vol. 44, 2001, pp. 132-3.

<sup>30</sup> See William Comanor, 'Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy', *Harvard Law Review*, Vol. 98, 1985, pp. 991-2.

reflect the infra-marginal consumers' preferences.<sup>31</sup> In other words, some consumers do not need the pre-sale service but should pay for that, especially when they have already obtained sufficient product information. Comanor stresses that vertical restraints are mostly beneficial to the manufacturer, and these restraints may not always improve economic efficiency.<sup>32</sup> However, some also argue that these marginal and infra-marginal theories cannot be used by courts to distinguish between efficient and inefficient systems of vertical restraints, because courts cannot obtain and process the information required for making this distinction.<sup>33</sup>

Rey and Stiglitz further criticise the Chicago School, in that the gains to manufacturers and distributors in vertical restraints are mostly at the cost of consumer welfare. Therefore, vertical restraints may not be socially desirable. They argue that vertical restraints may increase inter-brand competition, but some can still reduce it.<sup>34</sup> They consider the oligopolistic situation which reduces the incentive of competition by, for example, absolute territorial restriction. Territorial restriction can allow distributors to have a degree of dominant position to enjoy market power. This practice discourages manufacturers from reducing the price of supplying goods. Therefore, vertical restraints are harmful to consumers, and can make little changes in price-cutting, but only increase suppliers' profits. Nevertheless, to satisfy this argument, the existence of barriers to entry is critical in every market power analysis.<sup>35</sup> Because the Korean market has been considered as oligopolistic, Rey and Stiglitz's argument seemed plausible to assess the effects from the vertical restraints. Where the market is highly oligopolistic and also vertically integrated, firms may easily coordinate and successfully exploit their market power.<sup>36</sup> These market conditions, especially for a small economy, may have an adverse impact on prices and output levels of many goods and

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<sup>31</sup> For more discussion regarding infra-marginal consumers, see William Comanor, 'Economics of Vertical Arrangements' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, pp. 314-5.

<sup>32</sup> William Comanor, *Supra.*, note 30, pp. 992-9.

<sup>33</sup> See Don Boudreaux and Robert Ekelund, Jr., 'Inframarginal Consumers and the Per Se Legality of Vertical Restraints', *Hofstra Law Review*, Vol. 17, 1988, p. 148. The authors also argue that Comanor makes an erroneous assumption that economists are equipped to make interpersonal judgments concerning utility transfers or to make welfare comparisons, which is mostly not plausible. See also Eleanor Fox and Lawrence Sullivan, 'Anchoring Antitrust Economics – A Lexicon' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, pp. 77-8; Richard Posner, *Supra.*, note 25, p. 176.

<sup>34</sup> See Patrick Rey and Jean Tirole, 'The Logic of Vertical Restraints', *The American Economic Review*, Vol. 76, No. 5, 1986, pp. 921-39; Patrick Rey and Joseph Stiglitz, 'Vertical Restraints and Producers' Competition', *European Economic Review*, Vol. 32, 1988, pp. 561-8.

<sup>35</sup> See ABA, *Market Power Handbook: Competition Law and Economic Foundation*, ABA Publishing, Chicago, 2005, p. 119.

<sup>36</sup> Mark Furse, *Supra.*, note 16, pp. 378-9.

services, which can carry over to vertically inter-connected industries. This creates additional barriers to entry.<sup>37</sup> However, these arguments are also problematic. Whilst the theoretical models against positive results from vertical restraints suggest that the conclusions of the Chicago School are open to question, these do not establish clear-cut rules for determining when vertical relations are anti-competitive in a small economy. Moreover, even when monopolists use vertical restraints for anti-competitive reasons, the welfare implications of the theories are ambiguous.<sup>38</sup> More service, even standing alone, may or may not be beneficial.<sup>39</sup>

### 3.2.2. Economics-Theoretical Approaches to the Korean Market

It seems that the Harvard School's argument has been the basic rationale of Korean competition policy on vertical restraints, disregarding efficiency justification. The dominant fear has been that vertical restraints would foreclose a source of supply to rivals and thereby drive and fence out competitors, as had happened in the US.<sup>40</sup> The KFTC has, moreover, taken considerations of other challengers to the Chicago School, who have based their attacks on underlying assumptions and conditions. For example, vertical restraints can provide a means for firms to raise their rivals' costs and profitably reduce market output. This theory can be considered as one of the major assumptions that vertical restraints of large firms may inhibit competition in small market economies. They may raise foreign and domestic enterprises' costs by reducing supplies or by foreclosure.<sup>41</sup> In an imperfectly competitive upstream market, an enterprise with market power may also be able to exploit its market power by raising prices in the downstream level. There is one more reason why the KFTC does not easily accept the Chicagoans' theories. The analysis of vertical control is difficult at both theoretical and practical levels. Because of this, although the Chicago School offered an elegant, pro-market and largely anti-government vision of competition policy, the KFTC and

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<sup>37</sup> See Michal Gal, *Competition Policy for Small Market Economies*, Harvard University Press, Cambridge MA, USA and London, 2003, p. 22.

<sup>38</sup> Robert Hahn, *Supra.*, note 4, p. 4.

<sup>39</sup> See Frank Easterbrook, 'Vertical Arrangements and the Rule of Reason', *Antitrust Law Journal*, Vol. 53, 1984, p. 149.

<sup>40</sup> Robert Bork, *Supra.*, note 4, p. 225.

<sup>41</sup> See Michael Salinger, 'Vertical Mergers and Market Foreclosure', *The Quarterly Journal of Economics*, Vol. 103, No. 2, 1988, pp. 345-56. The author argues that a vertical merger, however, does not necessarily result in market foreclosure of un-integrated producers.

the courts would not accept its theories. The implementation in Korea has not ensured the Chicago theory as a dogma that is applicable to the market.

There are some issues of the incentives, which the KFTC and the courts should not ignore in both sides of economics schools, such as a number of interesting issues of vertical foreclosure<sup>42</sup> and transaction cost.<sup>43</sup> Vertical control can allow the foreclosure of the intermediate goods market by raising rivals' costs, resulting in the prevention of market entry. This can also facilitate collusion amongst producers and distributors. Such practices increase a firm's profits but at the expense of reduced competition and welfare.<sup>44</sup> The argument is whether this anti-competitive suspicion can be justified under the rationale given by the Chicago School.<sup>45</sup> Theoretical arguments from both sides are crucial for the Korean market to create better ideas. It can help the KFTC understand how to both achieve the benefits of tougher competition, and limit the negative impact. It also produces more coherent creative competition policy, as complementary instruments to foster economic growth. Competition is mainly growth-enhancing, because it forces enterprises to reduce costs and innovate in order to survive, through reducing transaction costs.<sup>46</sup> Lastly, the KFTC should not take one negative effect from one model, but take into account other aspects. For example, vertical relations assure the supply and efficiency results through transaction cost savings, but also create forms of market foreclosure.<sup>47</sup> It should balance the arguments of both Chicago and Harvard to find a marginal solution. This will bring a better outcome of trade-off, through seeking rents between efficiency, and anti-competitiveness by vertical restraints.

### 3.2.3. Theoretical Debates of Vertical Foreclosure in Korea

Vertical market foreclosure is more clearly anti-competitive than other subjects, as illustrated in the previous chapter. Vertical relations may give rise to market foreclosure by depriving

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<sup>42</sup> For further discussion, see Janusz Ordover, Garth Saloner and Steven Salop, *Supra.*, note 8, pp. 140-41.

<sup>43</sup> See Ronald Coase, 'The Nature of the Firm' *Economica*, Vol. 4, No. 16, 1937, pp. 396-7.

<sup>44</sup> See Khalid Sekkat, *Vertical Relationships and the Firm in the Global Economy*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p. 63.

<sup>45</sup> See Oliver Williamson, *Antitrust Economics*, Basil Blackwell, Cambridge MA, USA, 1989, pp. 44-5.

<sup>46</sup> See Phillip Aghion and Rachel Griffith, *Competition and Growth: Reconciling Theory and Evidence*, The MIT Press, MA, USA, 2005, pp. 3-4.

<sup>47</sup> See Patrick Bolton and Michael Whinston, 'Incomplete Contracts, Vertical Integration, and Supply Assurance', *The Review of Economic Studies*, Vol. 60, No. 1, 1993, p. 146.

competitors of a distribution network if a producer merges with a distributor.<sup>48</sup> In such cases there may be concerns when rivals at the horizontal level, either up- or downstream, do not have any alternative means.<sup>49</sup> Foreclosure or entry barrier also arises through contractual relations amongst independent firms.<sup>50</sup> When buyers and sellers agree to deal only with each other or impose costs for dealing with others, their rivals are excluded from suppliers or distributors with whom they might deal. Purchasers will be, thus, harmed by the elimination of other sellers.<sup>51</sup> Other types of vertical restraints may also create vertical foreclosure. For example, a primary reason for the criticism against tying is the leverage theory.<sup>52</sup>

Tying can be a profitable strategy for a monopolist because of its potential for excluding rivals. This exclusionary effect arises because of the strategic foreclosure.<sup>53</sup> In particular, once one allows for scale economies and strategic interaction, tying can make continued operation by a monopolist's rival in the tied market unprofitable by the foreclosure of tied good sales. Such a strategy can be profitable for a monopolist in the Korean market because of the exclusionary effect on the market structure.<sup>54</sup> A vertically integrated firm, or alternatively an exclusively contracted firm,<sup>55</sup> can have the power of either denying downstream rivals intermediate goods, or upstream competitors in the distribution. The integrated enterprise may attempt to squeeze a monopolistic price only at an excessive

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<sup>48</sup> E.g., the US case, *United States v. Paramount Pictures Inc.* 335 U.S. 131 (1948). In this case, there was a concerted action by the 5 vertically integrated firms.

<sup>49</sup> See Douglas Broder, *A Guide to US Antitrust Law*, Sweet & Maxwell, London, 2005, pp. 129-30; Mark Furse, *The Law of Merger Control in the EC and the UK*, Hart Publishing, Oxford, 2007, p. 41. This can facilitate collusion and foreclosure, which are the major concerns in merger control in the EC and the US.

<sup>50</sup> Entry barrier can be erected by a long-term contract. See Phillip Aghion and Patrick Bolton, 'Contracts as a Barrier to Entry', *The American Economic Review*, Vol. 77, No. 3, 1987, pp. 396-7; Dennis Carlton, 'Why Barriers to Entry Are Barriers to Understanding', *The American Economic Review*, Vol. 94, No. 2, 2004, p. 469. According to Carlton, however, entry barriers are concerned with the long-run, although the long-run may not be practically relevant for competition law proceedings.

<sup>51</sup> See William Comanor and Patrick Rey, 'Competition Policy Towards Vertical Foreclosure in A Global Economy' in Leonard Waverman, William Comanor and Akira Goto (eds), *Competition Policy in The Global Economy: Modalities for Cooperation*, Routledge, London and New York, 1997, p. 344; Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Supra.*, note 6, p. 258; Jay Pil Choi, 'Antitrust Analysis of Tying Arrangements' in Jay Pil Choi (ed), *Recent Developments in Antitrust: Theory and Evidence*, The MIT Press, Cambridge MA, USA and London, 2007, p. 62.

<sup>52</sup> See Michael Whinston, 'Tying, Foreclosure, and Exclusion', *The American Economic Review*, Vol. 80, No. 4, 1990, p. 837; Luc Peeperkorn and Vincent Verouden, *Supra.*, note 11, p. 67.

<sup>53</sup> Michael Whinston, *Ibid.*, p. 840.

<sup>54</sup> *Ibid.*, pp. 855-6.

<sup>55</sup> The primary alternative to vertical integration is an enforceable long-term contract. See Benjamin Klein, Robert Crawford, and Armen Alchian, 'Vertical Integration, Appropriable Rents, and the Competitive Contracting Process', *Journal of Law and Economics*, Vol. 21, No. 2, 1978, p. 302.

price.<sup>56</sup> Such a foreclosure effect may reduce competitiveness in both the up- and downstream markets. This is the reason why most competition authorities, including the KFTC, examine vertical integration and restraint based on foreclosure theory.<sup>57</sup>

The controversy surrounding the anti-competitive effects from foreclosure has, however, been cast in the context of vertical relations. Critics of the vertical foreclosure theory have raised a number of objections. Their theory implies that the strategy of foreclosure of supply will not increase the overall profitability of the integrated enterprise, because a vertically integrated firm will have no incentive to exclude its competitors, since rivals can protect themselves by merging or contracting with other un-integrated firms.<sup>58</sup> This will make them obtain the products at a competitive price level, thus reducing their disadvantage. If this is correct, the KFTC should reasonably assume that a vertical integration or contract will not have anti-competitive effects on the market, focusing on other possible functions of vertical relations such as reducing transaction costs<sup>59</sup> and controlling opportunistic behaviour in commercial relationships.<sup>60</sup> In a word, market entry might be hindered by the monopolist, but there are two strong objections to a rule forbidding such vertical relations of the firm. First, delaying new entry will have no anti-competitive effect if the market is competitive. Then, prices will be at the competitive level, whether or not entry is about to happen. Second, the simultaneous movement of a number of un-integrated producers to acquire suppliers reflects the existence of the economies of integration regarding transaction costs rather than an anti-competitive purpose, unless enterprises are already colluding.<sup>61</sup> This theory is plausible only if there are enough competitors in the market both up- and downstream, which means that the up- and downstream markets remain fairly competitive.<sup>62</sup>

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<sup>56</sup> See Einer Elhauge and Damien Geradin, *Global Competition Law and Economics*, Hart Publishing, Oxford and Portland Oregon, USA, 2007, pp. 418-9.

<sup>57</sup> See Lynn Pepall, Dan Richard, and George Norman, *Industrial Organization: Contemporary Theory & Practice*, 2nd edn, South-Western, USA, 2002, pp. 445-6.

<sup>58</sup> Giorgio Monti, *Supra.*, note 8, p. 183.

<sup>59</sup> See Oliver Williamson, 'Markets and Hierarchies: Some Elementary Considerations', *The American Economic Review*, Vol. 63, No. 2, 1973, pp. 317-20; Oliver Williamson, 'Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach', *University of Pennsylvania Law Review*, Vol. 127, No. 4, 1979, pp. 958-60.

<sup>60</sup> See William Page, 'The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency', *Virginia Law Review*, Vol. 75, No. 7, 1989, pp. 1233-4.

<sup>61</sup> See Richard Posner, 'Exclusionary Practices and the Antitrust Laws', *The University of Chicago Law Review*, Vol. 41, No. 3, 1974, pp. 523-7; Lynn Pepall, Dan Richard, and George Norman, *Supra.*, note 57, p. 449.

<sup>62</sup> Janusz Ordover, Garth Saloner and Steven Salop, *Supra.*, note 8, pp. 127-9.



An important setting where this problem can arise is in international trade. When vertical relations result in foreclosure, a foreign supplier may be unable to distribute his products effectively. The alternatives, then, become either to leave the market or to construct his distribution channel. In either case, costs can increase and foreign firms may be placed at a substantial disadvantage. On the contrary, if established distribution is open to all suppliers, there will be greater prospects for international trade and competition. How vertical relations are evaluated is thus an important matter in the Korean market.<sup>63</sup> Integration by *Chaebols* can be the means of market foreclosure, and this can give them more profits. That is why the KFTC heavily emphasises foreclosure and entry barriers, because these protect the exercise of market power over time.<sup>64</sup> In the current vertical merger decision, *POSCO/POSCOA*,<sup>65</sup> the KFTC stated that the merger would foreclose the market, thus strengthening horizontal market power and influence supply of the relevant products. Focusing on vertical foreclosure and entry barriers, the KFTC emphasised that a vertical merger would inhibit competition for the merging firm's market power.

Although vertical integration, by itself, has no immediate effect on market concentration at any stage, it can have entry-impeding consequences if the entry were to be inhibited to any but a fully integrated firm. Where the market is not highly concentrated, this anti-competitive potential is much less severe. Therefore, the presumption that vertical relationships are innocent or beneficial should be generally appreciated. Vertical control, once accomplished, does not commit the firm to continue the integrated relationship indefinitely.<sup>66</sup> Therefore, vertical integration and restraint other than foreclosure have little impact on international trade and competition.<sup>67</sup> The crucial point here is that the Korean market is much more open to foreign rivals, and the activities and competition from foreign firms can become vigorous. It is certain that, although the Korean market structure is concentrated, the real impact from it in the vertical level is not very significant. More entry

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<sup>63</sup> William Comanor and Patrick Rey, *Supra.*, note 51, pp. 344-5.

<sup>64</sup> See OECD, *Barriers to Entry*, DAF/COMP(2005)42, 2005, p.51:<http://www.oecd.org/dataoecd/43/49/36344429.pdf> (accessed 23 August 2008).

<sup>65</sup> *POSCO/POSCOA*, KFTC Decision 2007-351, 2007Kyoulhap1076, July 3, 2007.

<sup>66</sup> Oliver Williamson, *Supra.*, note 10, p. 259.

<sup>67</sup> See Eleanor Fox and Janusz Ordover, 'The Harmonization of Competition and Trade Law: The Case for Modest Linkages of Law and The Limits to Parochial State Action' in Leonard Waverman, William Comanor and Akira Goto (eds), *Competition Policy in The Global Economy: Modalities for Cooperation*, Routledge, London and New York, 1997, p. 424.

may be possible from trade. Furthermore, Korean competition law is not discriminatory against foreign firms, but domestic large firms.

### 3.3. Comparative Study: Development of Competition Laws in the US and the EU

#### 3.3.1. The United States

Section 1 of the Sherman Act prohibits any contract in restraints of trade such as RPM, territorial restrictions, and tie-in sales amongst the states, or with other foreign nations. In analysing vertical arrangements, it is important to take particular care to distinguish acceptable unilateral conduct from agreements that are part of a scheme of concerted anti-competitive conduct.<sup>68</sup> Section 1 condemns unreasonable vertical agreements, and has been applied to vertical price and non-price restraints. Section 2 of the Sherman Act, which condemns monopolisation and attempts to monopolise, also prohibits vertical practices by an enterprise that has significant market power. Monopolisation normally requires exclusionary conduct. Exactly what kind of conduct is judged to be exclusionary remains a subject of vigorous debate in recent US litigation.<sup>69</sup> Under the MRFTA, this is not a concern, since it prohibits abuse of market or monopoly power. It simply applies the law based on effects of market power and anti-competitive or unfair practices, rather than proving intent.<sup>70</sup> Section 3 of the Clayton Act and section 5 of the FTC Act prohibit any conduct affecting competition, such as tie-in sales.<sup>71</sup>

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<sup>68</sup> E.g., *United States v Colgate & Co.*, 250 U.S. 300 (1919); *United States v Parke, Davis & Co.*, 362 U.S. 29 (1960). For further discussion regarding development of inferring vertical agreements, also see Herbert Hovenkamp, *Supra.*, note 11, p. 58; ABA, *Antitrust Law Development, Vol. I*, 6th edn, ABA Publishing, Chicago, 2007, pp. 17-24.

<sup>69</sup> See Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Antitrust Analysis: Problems, Text, and Cases*, 6th edn, Aspen Publishing, New York, 2004, p. 368-402; Douglas Broder, *Supra.*, note 49, pp. 103-5. A plaintiff seeking to prove an attempt to monopolise does not need to prove that the defendant actually has monopoly power but should supply the following proofs: (i) the defendant has engaged in predatory or anti-competitive conduct with; (ii) a specific intent to monopolise; and (iii) a dangerous probability of achieving monopoly power, e.g., *Spectrum Sports v. McQuillan*, 506 US 447, 456 (1993).

<sup>70</sup> See Jungwon Song, *Ca-Ru-Tel-Mit-Bul-Gong-Jung-Go-Rae-Hang-Wi-Kyu-Jae [Regulations on Cartels and Unfair Business Practices]*, Pakyoungsa, Seoul, 2005, pp. 204-5.

<sup>71</sup> Herbert Hovenkamp, *Supra.*, note 12, p. 183; Douglas Broder, *Supra.*, note 49, p. 40. Sec. 3 Clayton Act, however, does not cover the tying of services or other intangibles.

Economic and legal debates in the US have brought the question of whether section 1 of the Sherman Act should prohibit vertical restraints that lack significant market power. However, it is unclear to which degree vertical restraints should be prohibited. Some commentators influenced by the Chicago School argue that all vertical restraints, even with market power, should be treated as legal per se.<sup>72</sup> The US antitrust authorities, therefore, do not provide market share threshold test legislation for this.<sup>73</sup> There has been quite a development in the US courts in vertical cases, influenced by the Chicago School. In the early stages of judgements on vertical restraints, the US courts condemned maximum RPM and territorial restrictions as illegal per se. However, at this time, the US Supreme Court found no section 1 of the Sherman Act violation by these restraints. The Court even recently overruled a thirty year precedent of minimum RPM, judging it under the rule of reason.

In the 1911 *Dr. Miles* case,<sup>74</sup> the US Supreme Court declared that RPM was a per se violation of section 1, thus placing RPM in the same position as horizontal price-fixing. The Court repeatedly upheld that position in subsequent cases, although in the 1980s it raised evidentiary standards for finding a defendant guilty of RPM. It declared that maximum RPM was a per se violation, reaffirmed in *Business Electronics*.<sup>75</sup> However, an important development was made in the 1997 *State Oil* case<sup>76</sup> involving maximum RPM.<sup>77</sup> The Court held that maximum RPM should be judged under the rule of reason.<sup>78</sup> Moreover, the Court recently abandoned per se rules on minimum RPM, and held that the *Dr. Miles* precedent should be overruled in the *Leegin* case.<sup>79</sup> The Court emphasised that minimum RPM can

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<sup>72</sup> Douglas Broder, *Supra.*, note 49, p. 55. For example, regarding per se illegality, a court does not have to examine anti-competitive effects in the case, because defence is not allowed. The per se illegal practices include horizontal price-fixing, bid-rigging, output restrictions, customer and market allocations, group boycotts, and certain tying arrangements. On the contrary, the rule of reason allows a court to investigate the argued practice as to whether it may be anti-competitive.

<sup>73</sup> See John Kwoka and Lawrence White (eds), *The Antitrust Revolution: Economics, Competition, and Policy*, 4th edn, Oxford University Press, New York, 2004, p. 335.

<sup>74</sup> *Dr. Miles Medical Co. v. John D. Park and Sons Co.*, 220 U.S. 373 (1911).

<sup>75</sup> *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 US 717, 724 (1988). The Court made it clear that for RPM to be per se illegal. However, they must do more than merely affect resale prices but there must be an agreement requiring the distributor to adhere to specific prices or price levels.

<sup>76</sup> *State Oil v. Khan*, 188 S. Ct. 145 (1997). For further discussion, see also Benjamin Klein, 'Distribution Restrictions Operate by Creating Dealer Profits: Explaining the Use of Maximum Resale Price Maintenance in *State Oil v. Khan*', *Supreme Court Economic Review*, Vol. 7, 1999, pp. 43-56; Gustavo Bamberger, 'Revisiting Maximum Resale Price Maintenance: *State Oil v. Khan* (1997)' in John Kwoka and Lawrence White (eds), *The Antitrust Revolution: Economics, Competition, and Policy*, 4th edn, Oxford University Press, New York, 2004, pp. 334-2

<sup>77</sup> This judgment overruled per se ban on maximum RPM of *Albrecht v. Herald Co.*, 390 US 145 (1968).

<sup>78</sup> John Kwoka and Lawrence White, *Supra.*, note 73, p. 329.

<sup>79</sup> *Leegin Creative Leather Products, Inc. v. PSKs, Inc.*, 551 US (2007).

stimulate inter-brand competition by reducing intra-brand competition. It also pointed out RPM may give consumers more options to choose amongst (i) low-price, low-service brands; (ii) high price, high-service brands; and (iii) brands falling in between. This case enables manufacturers to implement minimum RPM on the ground that the Court admitted the benefit of suppliers, considering consumer benefits by inter-brand competition. The Court agreed this arrangement can improve efficiency and competition through pre-sale services, just as the Chicago scholars argued. The Court has recognised that overall vertical restraints have real potential to stimulate inter-brand competition and has considered them unlawful only if they fail a rule of reason analysis,<sup>80</sup> the fundamental enquiry being whether or not the challenged restraint enhances competition.<sup>81</sup>

These remarkable judgments have been developed from precedents in non-price restraints. In the *Sylvania* case,<sup>82</sup> the US Supreme Court reversed the earlier precedent of per se illegality in territorial restriction. It held that US antitrust law must be driven by economic, not social or political, concerns. Furthermore, it observed that vertical restraints may be efficient and thereby enhance inter-brand competition, which are out of the concern of the law. This held the promise of fundamental reform, not only in the law of vertical restraints, but in antitrust law in general.<sup>83</sup> One of the considerable virtues in this case was its recognition that significant efficiencies could arise from vertical restraints, and thus to move antitrust law analysis to the point where it can take into account the relevant factors.<sup>84</sup> The Court's position has remained unchanged since then. Except for territorial restrictions, the Court and enforcement agencies were generally hostile towards tying, exclusive dealing, and other non-price vertical restraints until the mid-1970s. Since the 1970s, their approaches have become more sophisticated. The Court has added successive exceptions and evidentiary burdens to plaintiffs to win in a tying case, and other vertical restraints are judged under the

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<sup>80</sup> *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 US 717, 724 (1988). See also ABA, *Antitrust Law Developments*, Vol. 1, 6th edn, ABA Publishing, Chicago, 2007, p. 131.

<sup>81</sup> *California Dental Association v. FTC*, 526 US (1999) at 780. See also ABA, *Antitrust Law and Economics of Product Distribution*, ABA Publishing, Chicago, 2006, p. 25.

<sup>82</sup> *Continental T.V. v. GTE Sylvania*, 433 US 36 (1977).

<sup>83</sup> See Robert Bork, 'Vertical Restraints: Schwinn Overruled', *The Supreme Court Review*, Vol. 1977, 1977, p. 172.

<sup>84</sup> See Robert Pitofsky, 'The "Sylvania" Case; Antitrust Analysis of Non-Price Vertical Restrictions', *Columbia Law Review*, Vol. 78, No. 1, 1978, p. 9.

rule of reason, although the Court clearly stepped back from this trend in its *Kodak* judgment.<sup>85</sup>

The enforcement agencies have also moved away from a formalistic focus on restrictions and foreclosure. Instead, they have focused on practices that seem likely to raise rivals' costs or barriers to entry.<sup>86</sup> Exclusive dealing agreements are presumptively lawful, because they are deemed likely to be a means to increase efficiencies. Tying agreements, as noted, are subject to a modified per se rule. Tying and exclusive dealing can have net negative effects if they fence off so much that efficient rivals cannot survive. In such cases, prices can be raised and the practices likely to be found to be illegal under an effects-based rule of reason scrutiny.<sup>87</sup> Moreover, franchising agreements of vertical restraints hardly violate federal antitrust law, because these agreements are mostly justified in that they do not affect competition.<sup>88</sup>

To summarise, US antitrust law concerns about distribution have historically been great, and every substantive antitrust provision has been applied to the vertical practices. Furthermore, territorial restrictions in the *Sylvania* case, and also RPM in *Leegin*, are generally held as rational or justified by the rule of reason, unless the supplier abuses its market power. The *Leegin* judgment was revolutionary, since the US Court struck down the per se ban on the last of the hard-core restraints, minimum RPM, in view of its possible pro-competitiveness. Nevertheless, it seems that, more than the other vertical restraints, minimum RPM can still have harmful effects, such as facilitating a cartel, and thus remains illegal under the rule of reason.<sup>89</sup> The US courts have increasingly looked not only at the characteristics of the agreement, but also at the circumstances.<sup>90</sup> The US development in vertical cases has influenced the Korean regime. For instance, the RPM provision in the

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<sup>85</sup> *Eastman Kodak Co. v. Image Technical Service, Inc., et al.*, 504 US 451 (1992). For further discussion, see Keith Hylton, *Antitrust Law: Economic Theory and Common Law Evolution*, Cambridge University Press, Cambridge, 2003, pp. 229-301; Jeffrey Mackie-Mason and John Metzler, 'Links between Markets and Aftermarkets: Kodak (1997)' in John Kwoka and Lawrence White (eds), *The Antitrust Revolution: Economics, Competition, and Policy*, 4th edn, Oxford University Press, New York, 2004, pp. 440-46.

<sup>86</sup> John Kwoka and Lawrence White, *Supra.*, note 73, p. 330.

<sup>87</sup> See Eleanor Fox, 'Competition Law' in Andreas Lowenfeld, *International Economic Law*, 2nd edn, Oxford University Press, Oxford, 2008, p. 438.

<sup>88</sup> See Peter Klarfeld (ed), *Covenants Against Competition in Franchise Agreement*, 2nd edn, ABA Publishing, Chicago, 2003, Introduction.

<sup>89</sup> Keith Hylton, *Supra.*, note 85, p. 253; Eleanor Fox, *Supra.*, note 87, p. 438.

<sup>90</sup> See David Gerber, 'Competition Law', *The American Journal of Comparative Law*, Vol. 50, 2002, p. 297.

MRFTA seemed to be added when the MRFTA was legislated around 1980, due to the influence of US judgments on several RPM cases during the 1950-70s.

### 3.3.2. The European Union

The European Court of Justice (ECJ) and the EC Commission consider minimum RPM and absolute territorial restriction as unacceptable restrictions under Regulation 2790/99 OJ L336/21 (EC vertical regulation).<sup>91</sup> Where suppliers appoint a single distributor to supply one or several Member States, a territorial restriction with export bans may prevent inter-State trade. Since one of the main policies of EC competition law is market integration,<sup>92</sup> it has expressed its concerns about absolute territorial restriction. Competition law helps market integration by preventing private undertakings creating impediments to trade.<sup>93</sup> Although these can bring the efficiency of inter-brand competition with a small risk of inhibiting intra-brand competition, the EC Commission is unwilling to take the threats of hindering market integration.<sup>94</sup> In the early stages, the EC Commission was more concerned about vertical restraints than horizontal ones, because of the negative effects on trade between Member States.<sup>95</sup> However, it has adopted the economic justification for efficiency and shown its tolerance of vertical restraints.

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<sup>91</sup> Art. 4 of the Regulation 2790/99 OJ L336/21 on the application of Article 81(3) of the Treaty to categories of vertical agreements.

<sup>92</sup> E.g. Joint Cases 56 and 58/64, *Establissemments Consten SA & Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, 339-40, [1966] CMLR 418. The importance to create or maintain a single market is reflected in the priority given by the EC Commission to apply competition law to the practices that disintegrate the internal market. In particular, Arts. 2 and 3 EC Treaty state the task of establishing a single market of the Community. See also David Deacon, 'Vertical Restraints under EU Competition Law: New Directions' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Corporate Law 1996*, Juris Publishing and Sweet & Maxwell, New York and London, 1996, p. 308; David Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus*, Clarendon Press, Oxford, 1998, p. 2; Roger Van den Bergh and Peter Camesasca, *European Competition Law and Economics: A Comparative Perspective*, Intersentia, Antwerpen, Belgium, 2001, p. 2; Doris Hildebrand, *The Role of Economic Analysis in the EC Competition Rules*, 2nd edn, Kluwer Law International, The Hague, 2002, pp. 12-6; Giorgio Monti, *Supra.*, note 8, p. 39; Alison Jones and Brenda Sufrin, *EC Competition Law: Text, Cases, and Materials*, 3rd edn, Oxford University Press, Oxford, 2008, pp. 41-2; Mark Furse, *Supra.*, note 16, p. 27.

<sup>93</sup> Valentine Korah and Denis O'Sullivan, *Supra.*, note 27, p. 33; Okeoghene Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81*, Oxford University Press, Oxford, 2006, pp. 13-4.

<sup>94</sup> See Mark Furse, 'The Role of Competition Policy: A Survey', *European Competition Law Review*, Vol. 17, No. 4, 1996, pp. 255-6; Mario Filippini, Luc Peeperkorn and Donncadh Woods, 'Vertical Agreements' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, Oxford University Press, Oxford, 2007, p. 1132.

<sup>95</sup> Valentine Korah and Denis O'Sullivan, *Supra.*, note 27, p. 66.

Where inter-brand competition is vigorous, without threat of inhibiting market integration, it is unlikely that a vertical restraint will have a significant anti-competitive effect, even if it reduces intra-brand competition. Therefore, the most important factor is the distinction between inter- and intra-brand competitions in EC vertical regulation.<sup>96</sup> When both inter- and intra-brand competition are vigorous, there is even less danger of a vertical restraint having an anti-competitive effect. However, where inter-brand competition is weak, the vertical restraint can potentially lead to foreclosure or reduce price competition.<sup>97</sup> This is distinctive, since the EC Commission has developed its legal techniques in applying rules on vertical restraint through amending its regulations and adopting guidelines. Its current approach seems to be based on the belief that the main negative effect of vertical restraints is foreclosure by raising entry barriers, reduction of inter-brand competition, and obstacles to market integration, including limitations on the consumers' freedom to purchase goods and services.<sup>98</sup> The changing structure and techniques of distribution has pleaded for more market analysis based on economic rationale.<sup>99</sup>

The EC Commission applies the Article 81 EC Treaty so as to prohibit only vertical restraints that may have significant negative effects on the market. With a few major hard-core restrictions, vertical restraints are not viewed as positive or negative per se, and the analysis depends largely on the economic context in which they operate. However, restrictions on inter-brand competition, such as non-competitive clauses, are generally viewed as more likely to raise anti-competitive problems.<sup>100</sup> Article 81(1) EC prohibits all agreements which may affect trade between Member States and which prevent, restrict, or distort competition within the common market. Nevertheless, Article 81(3) EC, the EC vertical regulation,<sup>101</sup> and Guidelines on Vertical Restraints (EC vertical guidelines)<sup>102</sup>

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<sup>96</sup> See Frank Wijckmans, Filip Tuytschaever and Alain Vanderelst, *Vertical Agreements in EC Competition Law*, Oxford University Press, New York, 2006, p. 279.

<sup>97</sup> See Simon Bishop and Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, Sweet & Maxwell, London, 2002, p. 169.

<sup>98</sup> See Joanna Goyder, *EU Distribution Law*, 4th edn, Hart Publishing, Oxford, 2005, p. 67.

<sup>99</sup> David Deacon, *Supra.*, note 92, p. 321.

<sup>100</sup> Joanna Goyder, *Supra.*, note 98, p. 68.

<sup>101</sup> Regulation 2790/99 OJ L336/21 on the application of Article 81(3) of the Treaty to categories of vertical agreements. This regulation is also called, vertical Block Exemption Regulation (BER). See Doris Hildebrand, *Supra.*, note 92, p. 264.

<sup>102</sup> Guidelines on Vertical Restraints [2000] OJ C 291/01, [2000] 5 CMLR 1074.

provide exemptions from specific categories of vertical agreements.<sup>103</sup> The Commission's adoption of EC vertical regulation marked a shift in the policy towards vertical agreements. The EC Commission abandoned its formalistic approach and embraced a more economics-based assessment of vertical restraints.<sup>104</sup> The logic of prohibition and exemption in the enforcement of Article 81 EC towards vertical agreements can be seen to have remained at the centre of the enforcement, notwithstanding the changes that have been undertaken to make it more responsive to pressures from business and the legal community.<sup>105</sup> The EC Commission is aware that vertical restraints can have negative effects on competition only where significant market power exists,<sup>106</sup> although market power is not decisive where low entry barriers may render access to the market easy.<sup>107</sup> Therefore, the system of EC vertical regulation is relatively simple. All arrangements, where the market share of the supplier is not above 30 per cent safe harbour,<sup>108</sup> are permitted, except when the arrangement contains one of the blacklisted clauses. Article 4 of EC vertical regulation summarises the hard-core restrictions. The main type of such clauses concerns vertical price-fixing. Further, this category includes absolute territorial restrictions or limits on delivery to certain customers. Arrangements that contain such restrictions are void in their entirety.<sup>109</sup>

In addition to the application of the market share test, a vertical agreement will not be caught by Article 81(1) EC if it does not have an appreciable impact on competition or upon inter-State trade. The EC Commission has given guidance on its application in a series of Notices, and one of these regarding minor effects on the market is known as *de minimis* doctrine.<sup>110</sup> The notice is based on a market share test, and differentiates between horizontal

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<sup>103</sup> For further discussion about the historical development of the EC vertical regulation from the old regulations, see Doris Hildebrand, *Supra.*, note 92, pp. 248-61; Maurizio Gambardella and Francesco Salerno, *Supra.*, note 1, pp. 176-94.

<sup>104</sup> See Richard Whish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' *Common Market Law Review*, Vol. 37, 2000, p. 887.

<sup>105</sup> Maurizio Gambardella and Francesco Salerno, *Supra.*, note 1, p. 206.

<sup>106</sup> See Vincent Verouden, 'Vertical Agreements and Article 81(1) EC: The Evolving Role of Economic Analysis', *Antitrust Law Journal*, Vol. 71, 2003, pp. 526-7.

<sup>107</sup> EC Vertical Guidelines para. 119. See also Frank Wijckmans, Filip Tuytschaever and Alain Vanderelst, *Supra.*, note 96, p. 278.

<sup>108</sup> Initially, the EC Commission considered adopting 2 different market share thresholds, 20 or 40 per cent. However, this proposal was dropped because it could create more problems. For instance, 40 per cent was too high and very close to the presumption of market dominance. See Maurizio Gambardella and Francesco Salerno, *Supra.*, note 1, p. 198.

<sup>109</sup> Doris Hildebrand, *Supra.*, note 92, pp. 261-4; Piet Slot and Angus Johnston, *An Introduction to Competition Law*, Hart Publishing, Oxford, 2006, pp. 99-100; Einer Elhauge and Damien Geradin, *Supra.*, note 56, p. 658.

<sup>110</sup> Notice on agreements of minor importance [2001] OJ C368/13 [2002] 4 CMLR 699 (*de minimis* notice) gives sufficient guides of the safe harbour rule for vertical agreement exemptions. If the parties' market shares



and vertical agreements. Paragraph 7 of *de minimis* Notice states that an agreement will not appreciably restrict competition if the aggregate market share of the participating undertakings does not exceed 15 per cent of the relevant market for a vertical agreement. For mixed agreements of horizontal and vertical, the 10 per cent threshold is applicable, and the market share threshold is reduced to 5 per cent where a market is affected by networks of similar agreements.<sup>111</sup> The EC Commission allows agreements between Small and Medium-sized Enterprises (SME), which will be rarely capable of affecting trade between Member States.<sup>112</sup> However, although an agreement falls below the thresholds in the Notice, the agreement may still be considered to be appreciable if it contains one of the hard-core restrictions set out in paragraph 11, such as price-fixing, limitation of output, or allocation of markets.<sup>113</sup> If a vertical agreement falls within the scope of Article 81(1) EC, it requires exemption as provided for under Article 81(3) to be legal and enforceable. Hence, the undertaking can get exemptions granted (i) through block exemption of the EC vertical regulation; or (ii) by satisfying the four substantive criteria of Article 81(3). The market share threshold test is therefore important to prevent possible abuses from vertical agreements, since it is more likely for undertakings to get exemptions by the EC Commission's tolerance on vertical arrangements. This approach is clearly explained in paragraph 116 of the EC vertical guidelines. The EC Commission recognises the free-riding problem enough to justify vertical restraints that do not harm competition in the market.

With understanding of the market share threshold and free-riding justification, it is important to be aware of hard-core restrictions such as minimum RPM and absolute territorial restrictions. The ECJ and the EC Commission are hostile to these restrictions as mentioned above,<sup>114</sup> unlike the US authorities. The hard-core provisions are based on the EC competition aims of market integration. The key judgment was *Consten and Grundig*,<sup>115</sup> which remains one of the most important cases to be considered under Article 81 EC. This

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do not fall within *de minimis* threshold, they should be determined by the EC vertical regulation. For further details about the EC market share plans, see Richard Whish, *Competition Law*, 6th edn, Oxford University Press, New York, 2009, pp. 43-8.

<sup>111</sup> Para. 8 of the Notice.

<sup>112</sup> Para. 3 of the Notice.

<sup>113</sup> See Barry Rodger and Angus MacCulloch, *Competition Law and Policy in the EC and UK*, 3rd edn, Cavendish Publishing, London, 2004, pp. 179-80

<sup>114</sup> The EC vertical guidelines, paras. 46-56. See also Valentine Korah and Denis O'Sullivan, *Supra.*, note 27, p. 167.

<sup>115</sup> Joint Cases 56 and 58/64, *Établissements Consten SA & Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, 339-40, [1966] CMLR 418.

judgment demonstrated the application of most aspects of Article 81, by verifying the EC Commission's strict approach to territorial restrictions.<sup>116</sup> Nevertheless, recently, the ECJ and the EC Commission have adopted economic justifications for vertical restrictions. This allowance of special consideration has been established through case law, despite the rejection of the US rule of reason approach.<sup>117</sup> This economic justification has been stated in cases such as *Nungesser*,<sup>118</sup> *Pronuptia*,<sup>119</sup> *Remia*,<sup>120</sup> and *Erauw-Jacquéry Sprl*.<sup>121</sup> The consequence of adopting this economic justification was drawn from critiques by lawyers, economists, and business practitioners against the EC Commission's hostile attitude to vertical restraints.<sup>122</sup> Finally, through the provision of market share threshold, the EC Commission gives legal certainty to undertakings that practise vertical restraints. This guidance gives sufficient notice for undertakings to prevent them from abusing market power. Although it is not easy to define relevant market and measure market share, undertakings and competition authorities have recently practised and developed market definition and market share measurement.<sup>123</sup>

The importance of the block exemption is that it further reduces the scope of the principles in *Consten and Grundig*, and shows the appreciation of the law of vertical

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<sup>116</sup> Mark Furse, *Supra.*, note 16, pp. 183-9.

<sup>117</sup> Case T-528/93, *Métropole Télévision SA v. Commission* [1996] ECR II-649, [1996] 5 CMLR 386. The Court of First Instance (CFI) expressly rejected the rule of reason. However, it seems that the issues between Art. 81(3) EC and the rule of reason are still controversial in the EC. See also Mark Furse, *Supra.*, note 16, pp. 217-22; Richard Whish, *Supra.*, note 110, pp. 131-3.

<sup>118</sup> Case 258/78 *Nungesser (LC) KG & Kurt Eisele v. Commission* [1982] ECR 2015, [1983] 1 CMLR 278. In this case, the ECJ held that an open exclusive licence of new technology to certain products did not infringe Art. 81 EC. This is because of the risk of investment recoupment.

<sup>119</sup> Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 535, [1986] 1 CMLR 414. The ECJ approved franchising provisions restricting second outlet establishment and protecting the franchisor's know-how and reputation. For further discussion about the historical development of the EC approach from *Consten & Grundig* to *Pronuptia*, see Giuliano Amato, *Antitrust and the Bounds of Power: the Dilemma of Liberal Democracy in the History of the Market*, Hart Publishing, Oxford, 1997, pp. 47-54.

<sup>120</sup> Case 42/84 *Remia BV and NV Verenigde Bedrijven Nutricia v. Commission* [1985] ECR 2545, [1987] 1 CMLR 1. The ECJ held that the EC Commission failed to apply Art. 81(3) EC to assess the non-competition clause.

<sup>121</sup> Case C-27/87 *Erauw-Jacquéry Sprl v. La Hesbignonne Société Coopérative* [1988] ECR 1999, [1988] 4 CMLR 576. The ECJ accepted the provision of territorial protections falling outside Art. 81 EC under certain circumstances in the context of Intellectual Property Rights (IPR).

<sup>122</sup> Barry Roger and Angus MacCulloch, *Supra.*, note 113, p. 219; Stephen Hornsby, 'Competition Policy in the 80's: More Policy Less Competition', *European Law Review*, Vol. 12, No. 2, 1987, p. 79. Hornsby, however, states that more attention to economic justification does not mean that the EC Competition authority has abandoned its traditional policy on vertical restraints.

<sup>123</sup> E.g., Notice on the definition of relevant market [1997] OJ C 327/5.

agreement economics.<sup>124</sup> Along with EC vertical regulation, Article 81 EC also remains as a competition device forming a framework for the balance of anti- and pro-competitive effects.<sup>125</sup> Similar to, but unlike the US rule of reason approach, each agreement prohibited under Article 81 could only operate if it fulfilled the conditions for granting an individual exemption under Article 81(3). An alternative way from individual to block exemption solves the problems of lack of legal certainty as to whether the agreement would be given exemption.<sup>126</sup> Therefore, along with Article 81 EC, EC vertical regulation and guidelines prevent anti-competitive practices, at the same time allowing economic efficiency by vertical restraints.

### 3.4. Substantive Korean Competition Law

#### 3.4.1. Prohibition of Abuse of Dominant Position: Chapter 2 of the MRFTA

In order to understand the Korean competition law of vertical restraints (hereafter, vertical regulation), it is necessary to explain the framework of the MRFTA. To begin with, the MRFTA's control of economic power is one of the cornerstones of the MRFTA regarding vertical restraints. The concern about economic power has brought three major issues. First, the concentration of economic power by a few large firms has allowed a significant private influence on society including politics. Second, most of their affiliates have had dominant positions and created entry barriers that might cause distortion of competition. Third, these firms normally have a family-owned structure which brought problems of X-inefficiency,<sup>127</sup> which was only beneficial to the owner families.<sup>128</sup> This is because firms in a protected

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<sup>124</sup> See Femi Alese, *Federal Antitrust and EC Competition Law Analysis*, Ashgate, Hampshire and Burlington VT, USA, 2008, p. 158.

<sup>125</sup> See Lars Kjolbye, 'The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81', *European Competition Law Review*, Vol. 25, No. 9, 2004, pp. 566-70.

<sup>126</sup> See Rosa Greaves, *EC Block Exemption Regulations*, Chancery Law Publishing, Chichester and Colorado Springs CO, USA, 1994, p. 4.

<sup>127</sup> X-inefficiency is the difference between efficient behaviour of firms assumed or implied by economic theory, and their observed behaviour in practice. Economic theory assumes that the management of firms, in particular dominant ones, acts to maximise the owner's wealth by minimising risk and maximising economic profits. See also William Comanor and Harvey Leibenstein, 'Allocative Efficiency, X-Efficiency, and the Measurement of Welfare Losses', *Economica*, Vol. 36, No. 143, 1969, pp. 304-9; Kip Viscusi, Joseph Harrington, Jr., and John Vernon, *Supra.*, note 6, pp. 88-9.

<sup>128</sup> See Ohseung Kwon, 'Gong-Jung-Go-Rae-Ui-Gae-Yo-Wa-Jaeng-Jum (Introduction to Competition Law and Arguments)' in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Ko-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, p. 21.

market have insufficient incentives to keep their costs to a minimum.<sup>129</sup> Therefore, the KFTC has revised the MRFTA to prohibit any abusive practices of market dominance through providing the clauses of the presumption of market dominant enterprises where Concentration Ratio (CR) 1 is 50 or CR3 is 75 per cent under Article 4 MRFTA. The MRFTA does not directly prohibit the possession or acquisition of monopoly power.<sup>130</sup> Instead, it proscribes unreasonable or anti-competitive behaviour by large enterprises with substantial market shares.

In particular, Article 3-2 MRFTA forbids abusive conducts rather than monopolisation,<sup>131</sup> where a firm possesses a significant market share, whilst the US Sherman Act prohibits monopolisation or attempts to monopolise.<sup>132</sup> The Japanese Antimonopoly Law (AML) is similar to the US, but the Korean Law is closer to Article 82 EC. In the US *Alcoa* case,<sup>133</sup> the court sets out a two-pronged test for violation of section 2 of the Sherman Act as following: (i) a firm must have achieved monopoly power; and (ii) the power must have been achieved or maintained by means other than superior skill, foresight, and industry. By contrast, the EC standard under Article 82 EC follows that (i) the undertaking must have a dominant position; and (ii) it must have abused its dominant position. Therefore, Article 82 EC and Article 3-2 MRFTA only apply to firms in a dominant position.<sup>134</sup> In short, the text of these two provisions does not consider the concept of attempted monopolisation

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<sup>129</sup> See Michael Utton and A.D. Morgan, *Concentration and Foreign Trade*, Cambridge University Press, Cambridge, 1983, p. 59.

<sup>130</sup> Some scholars distinguish monopoly power from market power, however, in this thesis these terms will be regarded as the same. For further detail about the words, see ABA, *Supra.*, note 35, p. 3.

<sup>131</sup> This presumption clause was brought in 1999 regarding market dominance. See Soon-Sik Ju, 'Dok-Kwa-Jum-Kyu-Jae (Regulations on Monopoly and Oligopoly)' in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, p. 96; Byung-Ju Lee, 'Dok-Kwa-Jum-Juk-Si-Jang-Ku-Jo-Ui-Kae-Sun (Improvement in the Monopolistic and Oligopolistic Market)' in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, pp. 128-9.

<sup>132</sup> E.g., compared with the US case, *Aspen Skiing v. Aspen Highlands Skiing* [472 U.S. 585 (1985)], the *POSCO Co. v. KFTC* [Supreme Court 2002Du8626, Nov. 22, 2007] case is different in legal application in the meaning of prohibition of abusive conducts. See Korea Fair Trade Association, *Gong-Jung-Go-Rae-Kuk-Jae-Sa-Rae-Sim-Kyoul-Bi-Kyo [Cases of Comparative Competition Laws]*, Parkyoungsa, Seoul, 2003, p. 25; Herbert Hovenkamp, *Supra.*, note 11, pp. 272-5.

<sup>133</sup> *United States v. Aluminium Company of America, et al.*, 148 F. 2d 416 (1945).

<sup>134</sup> A high market share is not the definition of monopoly power in the US. However, the EC and the Korean standards do not accord with this. It defines market power in terms of market share, and does not explicitly deal with the efficient firm issue. See Franklin Fisher, 'Monopolization Versus Abuse of Dominant Position: An Economist's View' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Corporate Law 2004*, Juris Publishing, Huntington NY, USA, 2004, pp. 157-9; Neelie Kroes, 'Tackling Exclusionary Practices to Avoid Exploitation of Market Power: Some Preliminary Thoughts on the Policy Review of Article 82' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Competition Law 2006*, Juris Publishing, Huntington NY, USA, 2006, p. 384.

such as in US law, but rather seems to prohibit only abuses of existing market dominance. It does not appear to cover abusive conduct to create a dominant position.<sup>135</sup> However, another Korean provision, Article 23 MRFTA, seems to appear to prohibit practices which can be defined as somewhat similar to ‘attempted monopolisation’ in the Sherman Act. Article 23 covers more details than Article 3-2 does, and is characterised by the detailed specification under the Enforcement Decree of the MRFTA (Enforcement Decree),<sup>136</sup> and the Guidelines for the review unfair business practices (UBP Guidelines).<sup>137</sup>

In summary, the KFTC specifically identifies market dominant enterprises under Article 4 MRFTA criteria, although Article 23 applies regardless of market share. Thus, business activities by SMEs, which do not fall within the criteria, are not normally covered by Article 3-2, although such conducts may fall within the category of UBP prohibited under Articles 23 and 29.<sup>138</sup> An enterprise that the KFTC has deigned as a market dominant enterprise receives KFTC’s special scrutiny. The following conduct by market dominant firms constitute an Article 3-2 violation:<sup>139</sup> (i) determining, maintaining, or surcharging prices unreasonably for goods or services;<sup>140</sup> (ii) unreasonably controlling the sale of goods or services; (iii) unreasonably interfering with the business activities of other enterprises; (iv) unreasonably impeding the participation of new competitors; and (v) unfairly excluding competitive enterprises, which might considerably harm consumers’ interests.<sup>141</sup> Article 3-2 describes types of illegal abusive activities, but those activities are not treated as illegal per se. Instead, the statute speaks in subjective terms, such as ‘unreasonably’ and ‘unfairly’, which are vague. The logical implication is to require the KFTC first to demonstrate that the

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<sup>135</sup> For further comparison, see Einer Elhauge and Damien Geradin, *Supra.*, note 56, p. 441; Alison Jones and Brenda Sufrin, *Supra.*, note 92, pp. 345-6.

<sup>136</sup> Enforcement Decree of the Monopoly Regulation and Fair Trade Act amended by Presidential Decree, Dec. 3, 2008.

<sup>137</sup> The Guidelines for the review unfair business practice, established rule No. 26 of the KFTC amended on Mar. 11, 2005.

<sup>138</sup> See Seung-Wha Chang, ‘Competition Law and Policy in Transition’ in Carl Green and Douglas Rosenthal (eds), *Competition Regulation in the Pacific Rim*, Oceana Publications Inc., New York, 1996, pp. 268-9.

<sup>139</sup> For further detail, see also Bong Eui Lee, ‘Prohibition of Abuse of Market-Dominant Undertakings under the Monopoly Regulation and Fair Trade Act’, *Journal of Korean Law*, Vol. 4, No. 2, 2005, pp. 64-9.

<sup>140</sup> Art. 5(1) Enforcement Decree categorises the following circumstances as unreasonable pricing: (i) significant price increases or decreases that are not accounted for by objective market factors over a sustained period of time; (ii) sales and costs, which are in relation to those of comparable non-dominant firms in the same or a comparable industry, are excessive and unjustified; and (iii) price increases in the same or similar amounts by 2 or more dominant firms for the same product or service.

<sup>141</sup> The interest of consumers often refers to consumer protection, e.g., *Korea Electricity Corp.*, KFTC Decision 95-15, Apr. 4, 1995. In this case, the KFTC concluded that the firm’s electricity supply contract was abusive and violation of Art. 3-2, which harmed consumers.

challenged conduct falls within one of the enumerated categories in Article 3-2 after examining whether the enterprise is market dominant. It should, then, prove the conduct is ‘unreasonably’ or ‘unfairly’<sup>142</sup> anti-competitive. The KFTC has also developed Guidelines for reviewing the abuse of market dominant positions (Market Dominance Guidelines)<sup>143</sup> for determining whether a challenged activity falls within any one of the activities listed above.

### 3.4.2. Unfair Horizontal Concerted Acts: Chapters 4 and 6 of the MRFTA

The MRFTA proscribes a broad range of collusive activities of competitors. It contains provisions that specifically address anti-competitive conduct by trade associations. Article 19(1) in Chapter 4 of the MRFTA prohibits any agreement, whether by formal contract or otherwise, whereby enterprises engage in collaborative activity that substantially restricts competition. It specifically lists prohibited collusive activities: (i) fixing, maintaining, or changing prices; (ii) determining terms and conditions or payment of prices; (iii) restricting production, delivery, transportation, or transaction; (iv) limiting territory of trade or customers; (v) preventing establishment or extension of facilities or installation of equipment; (vi) restricting types or specifications in producing or transacting goods or services; (vii) jointly carrying out main parts of a business; and (viii) substantially lessening competition in a particular business area.

In general, competition requires uncertainty, and risks that a firm does not know how its competitors, trading partners, and consumers will act in the future. This uncertainty can make firms engage in competitive struggle at the horizontal level. However, a concerted practice enables them to act with greater knowledge and expectations about their rivals.<sup>144</sup> In order to prohibit these anti-competitive and collaborative activities, the KFTC must first prove that the allegedly improper conduct falls within at least one of the eight activities stated above. The KFTC should, then, prove the existence of an agreement to engage in the conduct. Because it is often difficult to prove an agreement of collusion, the 1992 amendment reduced the burden of proof for the KFTC by creating a statutory presumption of an agreement if it is

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<sup>142</sup> The meaning of unfairness in Art. 3-2 differs from that in Art. 23. According to the sec. III.1.A.(3) of the UBP Guidelines, the KFTC will examine the unfair condition in Art. 23 based on the balance test.

<sup>143</sup> KFTC Notification No. 2002-6 of the KFTC amended on May 16, 2002.

<sup>144</sup> Okeoghene Odudu, *Supra.*, note 93, p. 83.

shown that two or more firms in fact engaged in any anti-competitive activities on the list.<sup>145</sup> Any agreement to engage in anti-competitive activities is null and void between the parties under Article 19(4). In addition to being subject to the other prohibitions, enterprise organisations (or trade associations) are expressly prohibited from restricting membership size and unreasonably restricting members' business activities under Article 26 in Chapter 6 of the MRFTA. All enterprise organisations are also required to report to the KFTC when they are formed or dissolved. The KFTC has issued Enterprise Organisation Guidelines<sup>146</sup> in order to ensure compliance with the law. The Guidelines illustrates types of enterprise organisation activities that may constitute Article 26 violations.<sup>147</sup> However, this provision is only applicable to horizontal cases, and never applied to vertical ones, although there is no language limiting its scope within horizontal agreements. Furthermore, the courts have not developed a wider definition of this provision, unlike the EC and the Japanese.<sup>148</sup>

### 3.4.3. Vertical Restraints: Chapters 5 and 7 of the MRFTA

#### 3.4.3.1. Prohibitions of Unfair Business Practices

The MRFTA regulates a variety of anti-competitive restraints on distribution. A separate statute addresses restrictive practices in distribution or contract relations. It addresses the majority of restraints under the rubric of Unfair Business Practice (UBP) provision under Article 23 MRFTA, and specifically prohibits RPM under Article 29. However, these legal provisions are not only limited to unilateral restraints on distribution. In particular, UBPs can take the form of vertical or horizontal restraints, or any other types of restraint of trade. UBPs can also constitute violations of other sections of the MRFTA, such as those prohibiting unreasonable joint conduct, or abusive activities of market dominant positions.<sup>149</sup> Because most of the UBPs in the MRFTA are classified as vertical restraint, they are discussed in this

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<sup>145</sup> Seung-Wha Chang, *Supra.*, note 138, pp. 266-7.

<sup>146</sup> KFTC Notification 2002-14, amended in Dec. 2002.

<sup>147</sup> Seung-Wha Chang, *Supra.*, note 138, p. 268.

<sup>148</sup> E.g., Joint Cases 56 and 58/64, *Establissemments Consten SA & Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, 339-40, [1966] CMLR 418 in the EC and *Toppan Mua K.K. v. JFTC*, Tokyo High Court, Dec. 14, 1993, 840 *Hanreitimes* 81 in Japan.

<sup>149</sup> E.g., sec. III.1.A.(3) UBP Guidelines. 'Unreasonable' rather than 'unfair' UBPs will be regarded as quasi-per se violation. Such restraints are: (i) collective refusal to deal; (ii) discriminatory practice favouring affiliates; and (iii) predatory pricing in continuous business. See also Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, pp. 206-7.

section.<sup>150</sup> The list of prohibited acts specified in Article 23(1) establishes the scope and the determination criteria of UBPs.<sup>151</sup>

Any entrepreneurs shall not commit any act falling within the following list under Article 23, which is likely to impede competition or make an affiliate or other enterprises perform such conduct: (i) unfairly refusing any transaction, or discriminating against a certain partner; (ii) unfairly excluding competitors; (iii) unfairly coercing or inducing customers of competitors to deal;<sup>152</sup> (iv) making trade with a transacting partner by unfairly taking advantage of position; (v) trading under terms and conditions which unfairly restrict or disrupt business activities; (vi) assisting with a special interest by providing advanced payment, loans, manpower, immovable assets, stocks and bonds, or intellectual properties thereto, or by transacting under substantially favourable terms therewith; and (vii) threatening to impair trade by other means. The list of forbidden activities is, however, exhaustive where business practices do not fall within one of the enumerated categories.<sup>153</sup>

The KFTC is authorised to define types and elements of UBPs in more detail. The main reason is that the KFTC is in the best position to evaluate and specify the various forms of anti-competitive practices that its enforcement should encompass. As a practical matter, it is important to know the current requirements of Appendix 1 of the Enforcement Decree, since the KFTC's scrutiny of questionable conduct relies heavily on the criteria that the

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<sup>150</sup> Seung-Wha Chang, *Supra.*, note 138, p. 277.

<sup>151</sup> This category seems to be influenced by the Art. 19 AML whose types of UBPs are similar to the MRFTA: (i) concerted refusal to deal; (ii) other refusals to deal; (iii) discriminatory pricing; (iv) discriminatory treatment of transaction terms, etc; (v) discriminatory treatment in a trade association; (vi) unjustly low price sales; (vii) unjustly high price purchasing; (viii) deceptive customer inducement; (ix) customer inducement by unjust benefits; (x) tie-in sales, etc; (xi) dealing on exclusive terms; (xii) resale price maintenance; (xiii) dealing on restrictive terms; (xiv) abuse of dominant bargaining position; (xv) interference with a competitor's transaction; and (xvi) interference with the internal operation of a competitor's company. For details, see also Akira Inoue, *Japanese Antitrust Law Manual: Law, Cases, and Interpretation of Japanese Antimonopoly Law*, Kluwer Law International, Alphen aan den Rijn, 2007, p. 2.

<sup>152</sup> The wording, 'coercion' often appears as an important factor in the Korean enforcement. The rise of neoclassicism in economics and law effected a substantial change in the meaning of coercion. Someone who is merely asked to pay a high price for a particular commodity was not coerced. However, neo-classicists viewed the problem of free choice and restraint in a more subtle way. Coercion is something that can exist in degrees, and the market itself can coerce. In US antitrust history, most agreed that certain kinds of agreements were coercive and ought to be condemned, but determining where the line should be drawn between competitive and coercive activities proved to be very difficult. In Korea, this problem has not been discussed fully but the meaning of coercion under the MRFTA was added in order to protect SMEs and consumers from large firms. See Herbert Hovenkamp, 'The Sherman Act and the Classical Theory of Competition' in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, p. 151.

<sup>153</sup> Seung-Wha Chang, *Supra.*, note 138, p. 278.



provision enunciates. In addition, the KFTC articulates formulated criteria for certain practices such as offers of premiums, bargain sales, and large retail businesses by issuing some guidelines<sup>154</sup> for assessing the legality of practices through categorised details. This overall implementation of the law indicates that the Korean policy-makers seemed to adopt the provisions of UBP of the AML. Article 23 MRFTA follows the main structure of the AML.<sup>155</sup> Therefore, it would be better to compare the AML with the MRFTA.<sup>156</sup> The Japan Fair Trade Commission (JFTC) is authorised to designate UBPs, and such conduct is subject to prohibition under Article 19 AML.<sup>157</sup>

The UBP provision in the AML was expected to play a supplemental role in the enforcement. However, it has long been considered as the core provision of the enforcement in Japan. It has also caused substantial confusion regarding the application of law.<sup>158</sup> Regarding the matter of vertical restraints, this provision refers to individual refusal to deal (unreasonable discrimination), tie-ins (unreasonable coercion), exclusive dealing,<sup>159</sup> RPM (unreasonable restriction of business activities),<sup>160</sup> and territorial restriction (other restrictions).<sup>161</sup> There is a sharp contrast between the form and substance of policy measures towards vertical restraints in Japan. Under the AML, most practices are adjudicated under the rule of reason, and vertical restraints constitute UBPs if they have ‘a tendency to impede fair competition’.<sup>162</sup> However, there is a common implementation of UBP provisions in both

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<sup>154</sup> E.g., Notification on the Types of and Criteria for Special Unfair Business Practices Relating to Large Retail Store Business, KFTC Notification No. 2001-9 amended on July 6, 2001; Notification of Types of and Criteria for Unfair Business Practices and Abuse of Market-Dominant Position Relating to Newspaper Business, KFTC Notification No. 2003-3 amended on May 27, 2003.

<sup>155</sup> Jungwon Song, *Supra.*, note 70, p. 203.

<sup>156</sup> Art. 2(9) AML defines UBPs as ‘any act, coming under any one of the following paragraphs, which tends to impede fair competition and which is designated by the authority.’ The provision goes on the list (i) unreasonable discrimination, (ii) unreasonable price, (iii) unreasonable inducement or coercion of customers, (iv) unreasonable restriction imposed on the other party to a transaction, (v) unreasonable use of bargaining position, and (vi) unreasonable interference in the affairs of a competitor.

<sup>157</sup> See Mitsuo Matsushita, *Introduction to Japanese Antimonopoly Law*, Yuhikaki Publishing, Tokyo, 1990, p. 54.

<sup>158</sup> Akira Inoue, *Supra.*, note 151, p. 8.

<sup>159</sup> There is no general rule concerning the minimum market share to invoke exclusive dealing provision. However, 25 per cent of market share can be assumed as an evidence of substantial power, which can infringe Japanese UBP provision. See Mitsuo Matsushita, *Supra.*, note 157, p. 61.

<sup>160</sup> The MRFTA has a separated provision of RPM. This is different from the AML. However, RPM under the AML is also per se violation. For further comparison, see Ulrike Schaeede, *Cooperative Capitalism: Self-Regulation, Trade Associations, and the Antimonopoly Law in Japan*, Oxford University Press, Oxford, 2000, pp. 130-34.

<sup>161</sup> Mitsuo Matsushita, *Supra.*, note 157, p. 62.

<sup>162</sup> ‘Tendency’ can be normally defined as the possibility of impeding fair competition. William Comanor and Patrick Rey, *Supra.*, note 51, p. 353. For further details, see also Jiro Tamura, ‘Competition Policy in Japan: A

regimes. The AML also emphasises fairness in competition. For example, in the large retailer cases in Japan of *Lawson*<sup>163</sup> and *Uny*,<sup>164</sup> the JFTC stressed bargaining position could be regarded as unfair pressure inhibiting fundamentals of fair and free competition under Article 1 AML.<sup>165</sup> To summarise the common features of UBP provisions in Korea and Japan, these regulations can be characterised as following: (i) a detailed definition of the unlawful conduct; (ii) less scrutiny for impact on competition; (iii) a lighter penalty compared with the provision of abuse of market dominance.<sup>166</sup>

Besides, the KFTC has a unique procedure of examining UBPs. In 2005 the KFTC established the UBP Guidelines, which clarify the standards for reviewing UBPs and thereby ensure the transparency of the review process. The Guidelines are based on the KFTC's administrative decisions and court judgments. If the KFTC determines that an enterprise has engaged in UBP, the KFTC may impose a corrective measure such as discontinuation of the practice, and an administrative fine not exceeding two per cent of the enterprise's total sales turnover.<sup>167</sup> Where the case is related to unfairness, the KFTC first examines whether the practice satisfies the condition falling within UBP types. Then, it defines the market and examines whether the market share is less than 10 per cent,<sup>168</sup> and also whether the effect of the practice is trivial. If the conduct can distort competition, the KFTC scrutinises whether the practice may enhance efficiency or improve consumer welfare. However, the KFTC does not have to follow this procedure.<sup>169</sup> If the enterprise meets one of the exemption conditions with sufficient evidence, the KFTC may drop the case. This procedure can be regarded as efficiency justification procedure, although the burden of proof is on the defendants.<sup>170</sup>

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New Necessity for A Mature Economy' in Carl Green and Douglas Rosenthal (eds), *Competition Regulation in The Pacific Rim*, Oceana Publications, New York, 1996, p. 207.

<sup>163</sup> *Lawson Inc.*, JFTC Decision, July 30, 1998, *Shinketushu* 45-136. The JFTC found that the second largest convenience chain store, *Lawson*, abused its buying power.

<sup>164</sup> *Uny Co. Ltd.*, JFTC Decision, Jan. 7, 2005, *Shinketushu* 51-543. *Uny* held a bargaining position and abused its power.

<sup>165</sup> For discussion, see also Masako Wakui, *Antimonopoly Law: Competition Law and Policy in Japan*, Arima Publishing, Suffolk, 2008, pp. 171-5.

<sup>166</sup> *Ibid.*, p. 103.

<sup>167</sup> Arts. 24 and 24-2. See also Sai Ree Yun and Dae Sik Hong, 'Korea: Overview', *Global Competition Law Review*: [http://www.globalcompetitionreview.com/sr/sr\\_fullpage.cfm?page\\_id=622](http://www.globalcompetitionreview.com/sr/sr_fullpage.cfm?page_id=622) (accessed 20 April 2008).

<sup>168</sup> Sec. III.2. of the UBP Guidelines.

<sup>169</sup> Jungwon Song, *Supra.*, note 70, p. 221.

<sup>170</sup> *Ibid.*, pp. 213-4; Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 149, pp. 206-7.

Nonetheless, if the conduct is defined as unreasonable, it shall be regarded as a near-per se violation. Examples of per se illegal conduct are collective refusal to deal, discriminatory transactions to affiliates, and successive predatory pricing.<sup>171</sup> In addition, often the KFTC does not examine whether the enterprise has any intention of abusive UBP conducts, but only considers violation of the law based on the outcome and effect of the conduct,<sup>172</sup> because intentions are often unknowable or ambiguous.<sup>173</sup> The UBP Guidelines define a ‘safety zone’ as an exemption based on 10 per cent market share, where an enterprise’s business practice does not affect the market. However, the KFTC may also find per se violation of conduct although market share is below 10 per cent, where the conduct inhibits competition significantly without any efficiency gains. This safety zone provision applies to each type of UBP except abuse of dominance, coercing consumers, and coercing transaction.<sup>174</sup>

Compared with this, US antitrust agencies do not offer any legal measures of market share threshold exemption, although the EC Commission sets a safe harbour of 30 per cent with the hard-core restrictions. The Korean safety zone provision can be, however, regarded as merely *de minimis* provision rather than an EC-style block exemption regulation. There is another issue with regards to defining the wording in Article 23, ‘unfairness’ and ‘harming fair competition’. Unfairness enforcement under Article 23 is often covered as a catch-all measure, although Article 3-2’s interpretation of unfairness is treated somewhat differently. Many also agree on a possible rule of reason enforcement in Article 23. A UBP conduct ‘without proper reason’ can be treated as a quasi-per se violation. However, if the enterprise satisfies a rational reason for this conduct, its practice is likely to be justified.<sup>175</sup> Nevertheless, it is still difficult to define the criteria of violation of the law under the terms ‘unfairness’ and ‘proper reason’. The KFTC seems to define ‘without proper reason’ narrowly when applying it to cases of discriminatory practices favouring affiliates, and collective refusal to deal

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<sup>171</sup> Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 149, p. 206.

<sup>172</sup> Jungwon Song, *Supra.*, note 70, pp. 204-5. However, the courts often examine intentions of the firm, e.g., *Coca-Cola Co. v. KFTC*, Supreme Court 98Du17869, Jan. 5, 2001.

<sup>173</sup> For further discussion about wilful conduct element in the US regime, see Phillip Areeda, ‘Monopolization, Mergers, and Markets: A Century Past and the Future’ *California Law Review*, Vol. 75, No. 3, 1987, p. 963; Einer Elhauge, ‘Defining Better Monopolization Standards’, *Stanford Law Review*, Vol. 56, No. 2, 2003, p. 261.

<sup>174</sup> Jungwon Song, *Supra.*, note 70, pp. 211-2.

<sup>175</sup> See Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 6th edn, Bubmunsa, Seoul, 2008, p. 279.

only.<sup>176</sup> Nonetheless, the case law or statute law does not give clear definitions of these terms. Some Korean lawyers argue that this provision can create misapplication of the law since Article 23 can blame all possible business practices regardless of market power.<sup>177</sup> This can result in administrative abuses of competition law enforcement.

### 3.4.3.2. Prohibitions of Resale Price Maintenance

Article 29 in Chapter 7 of the MRFTA proscribes RPM which could fall into one or more of the categories constituting UBPs.<sup>178</sup> Article 29(1) seems to be a per se rule on minimum RPM according to Guidelines of the review resale price maintenance (RPM Guidelines).<sup>179</sup> This legislation may be the influence of *ex* Article 14 of the German *Gesetz gegen Wettbewerbsbeschränkungen* (GWB). This provision is unique since there are not many regimes which have RPM provisions. The criteria of violation of RPM provision are: (i) a price arrangement between up- and downstream firms;<sup>180</sup> and (ii) a degree of coerciveness in the practice.<sup>181</sup> However, this provision shall not apply to a case where there exist justifiable reasons in terms of maximum RPM. Moreover, the provisions of Article 29(1) shall not apply to literary works prescribed under the Article 43 of Enforcement Decree.<sup>182</sup> In addition, an enterprise can get exemption through KFTC authorisation where its products meet the following conditions: (i) the uniform quality of the commodity concerned is easily identifiable; (ii) the commodity concerned is used daily by ordinary customers; and (iii) free competition exists with respect to the commodity concerned.<sup>183</sup>

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<sup>176</sup> E.g., *Jungsan Co v KFTC*, Supreme Court 89DaKa29075, Apr. 10, 1990. The Court stated that the reasonableness shall be assessed by the perspective of fair competitiveness rather than the need of business practice. See also Meong Cho Yang, *Kyoung-Jae-Bub-Kang-Ui [Lectures on Competition Law]*, 6th edn, Shinchosa, Seoul, 2008, p. 199.

<sup>177</sup> See Young-Chul Lim, *Gong-Jung-Go-Rae-Bub [Korean Competition law]*, Bubmunsa, Seoul, 2007, p. 301.

<sup>178</sup> Seung-Wha Chang, *Supra.*, note 138, p. 279.

<sup>179</sup> Guidelines for review resale price maintenance, KFTC Established rule No. 34 enacted on Aug. 30, 2006.

<sup>180</sup> The KFTC only articulated the criteria of deciding independent agency relationship in up- and downstream levels, e.g., *Daeha Fashion Corp.*, KFTC Decision 96-193, 9607Choi1105, Aug. 21, 1996.

<sup>181</sup> See Won-Ki Kim and Su-Young Park, *Dok-Jum-Kyu-Jae-Bub [Korean Anti-trust Law]*, Daemyoung Publishing, Seoul, 2007, 409; Ohseung Kwon, *Supra.*, note 175, pp. 345-6. Kim and Park illustrate the examples of coercive means in the Korean regime, such as warning, imposing fines of breach of contract, refusal to supply, termination of contracts, or rebates.

<sup>182</sup> Art. 29(2) MRFTA and Category of RPM Literary Works of KFTC Guidelines No. 2002-15, Dec. 2002. This provision is similar to Art. 23(4) AML, the exemption of RPM on literary works.

<sup>183</sup> Arts. 29(2) and (4) MRFTA.

Upon petition by an interested party, the KFTC will designate in advance the products that fall within these exemptions, and can publish that determination. However, the resale pricing of products on the KFTC's exempted list is still subject to KFTC supervision. When a seller has determined the RPM and wishes to enter into a contract specifying the price, he must inform the KFTC of the contract's details.<sup>184</sup> The KFTC may order the seller to change the contract if it may harm the interests of consumers or otherwise be adverse to public interest. This individual exemption becomes scaled down. Only two products, cosmetics (1981) and pharmaceutical products (1985), were authorised by the KFTC as falling under exemptions. However, the KFTC later rescinded both designations, in 1985 and 1987 respectively. Since then, the KFTC has virtually applied a per se rule to RPM of all products.<sup>185</sup>

### 3.5. Concluding Remarks

This chapter observed general issues and problems in vertical restraints based on economics and a comparative study. Article 3-2 MRFTA prevents vertical practices such as refusal to deal, exclusive dealing, and tying. Article 23 also sets a yardstick for vertical restraints by categorising certain types of UBPs. The problem of implementation arises whether the KFTC shall apply Article 3-2 or 23 if a large enterprise violates both. Most commentators agree that the KFTC puts a higher priority on applying Article 3-2 to cases of abusive conduct than Article 23, therefore Article 3-2 should be applied foremost. There are two rationales as grounds for this.<sup>186</sup> First, Article 3-2 is provided for actual abusive conduct limited to large enterprises with dominant market positions. Korean competition policy has developed for and focused on preventing large business groups' abusive conduct. Hence, Article 3-2 is the special provision prior to Article 23. Second, the Article 3-2 has a limited category of application, especially for large enterprises. Since the penalty for violation of Article 3-2 is heavier than that in Article 23, it can be plausible for the KFTC to apply Article 3-2 to effectively prevent anti-competitive effects that are more influential on the market. In addition, the KFTC generally considers RPM as a per se violation with some exemption conditions such as Articles 43 (publications) and 44 (procedures for designating products) of

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<sup>184</sup> Art. 44 of the Enforcement Decree.

<sup>185</sup> Seung-Wha Chang, *Supra.*, note 138, pp. 279-80.

<sup>186</sup> See Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsu, Seoul, 2005, p. 335.

Enforcement Decree. Article 29(1) MRFTA also states that the law shall not apply to the case of maximum RPM. The anti-competitiveness of recommended RPM shall be, then, decided on whether the price scheme is coercive.<sup>187</sup> However, minimum RPM is prohibited as illegal per se.

The KFTC has focused on the development of competition law measures in order to regulate the market power of large enterprises. Large business groups could leverage their powers to enter a market or strengthen their position in the global market. If the Korean market is somewhat closed and the entry barriers are not a reflection of government restraints, they can be a reflection of private restraints. Therefore, if the KFTC does nothing to eliminate these restraints, other regimes may sue offending Korean enterprises in their territories under their competition laws, such as happened between the US and Japan.<sup>188</sup> Considering all of these, the ideology of economics and a comparative study give further indication of the current implementation of the MRFTA. Most of the legal provisions on vertical restraints and case law were left rather underdeveloped in Korea, although the aims of both regulating concentration of market power, and enhancing competition, are featured. The major task of the competition authority is how to make the domestic market more competitive without hindering international trade. The next chapter will discuss this issue through a critical assessment of case studies.

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<sup>187</sup> E.g., *Daeha Fashion Co.*, KFTC Decision 96-193, 9607Choil1105, Aug. 21, 1996; *Namyang Co.*, KFTC Decision 98-112, 9804Dokkwan0559, June 9, 1998. The KFTC examined the actual coercive conducts of the recommended RPM that could be regarded as per se violation in these cases.

<sup>188</sup> Eleanor Fox, *Supra.*, note 87, p. 428-9.

## Chapter 4

### Critical Review of Korean Case Law: Competition Policy Ramification

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#### 4.1. Overview

The Korea Fair Trade Commission (KFTC) used to be attacked for its lethargic application of Article 3-2 Monopoly Regulation and Fair Trade Act (MRFTA). It has not set sufficient guidance and application of the relevant law on vertical restraints. The total number of Article 3-2 cases for the last ten years is 51, and 37 of them were made in 2007, as shown in the table below. On the other hand, the number of Article 23 violations is 3,065 during the same period.

	Article 3-2 MRFTA	Article 19 MRFTA	Article 23 MRFTA
1998	5	37	407
1999	2	34	172
2000	-	47	121
2001	4	42	169
2002	-	47	210
2003	1	23	123
2004	-	35	298
2005	-	46	481
2006	2	46	369
2007	37	44	715
Total	51	401	3,065

Figure 4.1. Number of cases by types of violation (Source: The KFTC 2008 Annual Report)<sup>1</sup>

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<sup>1</sup> KFTC, 2008 Annual Report, p. 112: <http://eng.ftc.go.kr> (accessed 5 Dec. 2008). 2008 data are not available.

This indicates that the KFTC relies heavily on Article 23 application rather than 3-2, because Article 23 catches all cases, which appears to be without economic rationale. Economic theories on vertical restraints have evolved and influenced Korean competition policy as much as other competition regimes. These theories helped the KFTC provide the Unfair Business Practice (UBP) and the Resale Price Maintenance (RPM) guidelines. In addition, the Seoul High Court (appeal court) and the Supreme Court of Korea started considering economic principles that have been discussed in the competition courts in other countries. It seems, however, that the KFTC and the courts have not established sufficient level of economic thought in vertical cases. In particular, economic arguments can be hardly observed in the vertical case decisions and judgments although anti-competitive harm is most likely to occur in markets where the gains from vertical restraints are ignored. Before encountering the problems in vertical regulation in the MRFTA, this chapter will present a critical analysis of KFTC decisions and case law regarding practices to which both Articles 3-2 and 23 could be applicable, such as refusal to deal, tie-ins, exclusive dealing, territorial restriction, and RPM. This chapter will assess the implementation of the law on vertical restraints and court judgments in Korea through economics, and a comparative study with reference to the US, the EC, and Japan. It will be discussed how and by what means the KFTC and the courts have been able to establish the approach to vertical restraints, and what the outcomes will be from current legal approaches, such as development of the rule of reason and per se rule. This chapter will then conclude with a question of desirable proposal reform to the vertical regulation. The requests and proposals for reform will be further discussed in the next two chapters.

## 4.2. Refusal to Deal

### 4.2.1. Establishment of Relevant Provisions and Problems

Refusal to deal can be attacked under Article 3-2 MRFTA, accordingly ‘the provision of unfair interfering business clause’.<sup>2</sup> There is a problem of application of Articles 3-2 and 23

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<sup>2</sup> A breach of contract in franchising without proper reason can also infringe the law, e.g., *Lotteria Ltd v KFTC*, Supreme Court 2002Du332, Mar. 10, 2006.



MRFTA because Article 23 can be also applied in a refusal to deal case regardless of market power. The KFTC prevents refusal to deal mostly under Article 23, because it is easier for the KFTC to apply this catch-all provision.<sup>3</sup> In particular, these provisions do not distinguish between horizontal or vertical and unilateral or concerted practices. Section 1 of the Enforcement Decree<sup>4</sup> Appendix 1 defines that an unreasonable refusal to transact under Article 23 implies two kinds of refusal to deal, collective and other types of refusals to deal.<sup>5</sup> The collective refusal to deal is mostly related to horizontal arrangements,<sup>6</sup> and the other types of refusal to deal can be considered as unilateral vertical restraint. The unilateral refusal to deal is defined as an unreasonable refusal to initiate business, suspend transaction, or significantly restrict the quantity, nature of commodities, and services in transaction with regard to a certain enterprise in a continuous transaction relation.<sup>7</sup>

The KFTC adopts the rule of reason to this type of refusal to deal.<sup>8</sup> Under UBP Guidelines, the KFTC examines whether there is any anti-competitive effect in that practice such as essentiality of supply, difficulties in finding substitute goods, potential entry barrier, and methods of coercing other anti-competitive behaviours.<sup>9</sup> If there is any objective justification, such as lack of supply ability or improvement of efficiency and consumer

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<sup>3</sup> See Jae-Hyoung Lee, *Regulations on Refusal to Deal and Economic Analysis*, Korea Development Institute, Seoul, 2005, p. 21; Sang-Yong Park and Ki-Sup Um, *Kyoung-Jae-Bub-Wol-Lon [The Principle of Economic Law]*, 2nd edn, Parkyoungsa, Seoul, 2006, p. 274.

<sup>4</sup> Enforcement Decree of the Monopoly Regulation and Fair Trade Act amended by Presidential Decree, Dec. 3, 2008.

<sup>5</sup> This is stipulated in the first half of subpara. 1 of Art. 23(1) MRFTA.

<sup>6</sup> Most collective refusal cases have been covered by Art. 19 MRFTA since Art. 19 is foremost applied under the sec. V.1.A.(2) of the UBP Guidelines, e.g., *Four Department Stores*, KFTC Decision 2002-340, 2002Yougo1083, Nov. 28, 2002; *Eight Cosmetics companies*, KFTC Decision 2002-369, 2002Danchae1701, Dec. 24, 2002. Some scholars argue that there is a difference between Arts. 19 and 23 regarding collective refusals since Art. 19 covers agreements which inhibit competition between competitors but Art. 23 covers acquiescence of hindering third parties regardless horizontal or vertical. However, in practice, this distinction is not very significant. The KFTC considers that a collective refusal to deal creates serious distortion of competition. Thus, the KFTC regards it as quasi-per se violation, e.g., *Seven Banks refusal to deal against Samsung Card Co.*, KFTC Decision 2002-001, 2001Dokjom2503, Jan. 8, 2002. In this case, the KFTC decided banks' collective refusal to deal against *Samsung Card* as quasi-per se illegal by considering serious effects of raising rivals' cost. See also Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, pp. 208-9.

<sup>7</sup> E.g., *Hanil Co.*, KFTC Decision 94-196, 9405Kusa326, July 14, 1994, affirmed by the Seoul High Court 94Gu34120, Dec. 14, 1995; *Coca-Cola Korea Co.*, KFTC Decision 97-133, 9704Kyungchok0614, Aug. 27, 1997 and appealed *Coca-Cola Korea Co. v. KFTC*, Seoul High Court 97Ku53139, Oct. 1998; Supreme Court 98Du17869, Jan. 5, 2001. The KFTC examined the anti-competitive refusal to deal as an essential facility strategy in *Coca-Cola*. The Seoul High Court upheld the KFTC's decision. However, the Supreme Court reversed the High Court's ruling.

<sup>8</sup> See Jungwon Song, *Ca-Ru-Tel-Mit-Bul-Gong-Jung-Go-Rae-Hang-Wi-Kyu-Jae [Regulations on Cartels and Unfair Business Practices]*, Pakyoungsa, Seoul, 2005, p. 225.

<sup>9</sup> Sec. V.I.B.(2)(C) of the UBP Guidelines

welfare, which weighs over anti-competitive harms, the refusal to deal can be investigated under the rule of reason. Moreover, if an enterprise satisfies the threshold of 10 per cent market share or two billion Korean Won (KRW) of yearly turnover, it may get benefits of exemption according to the safety zone.<sup>10</sup>

The criteria of exemption clauses, however, do not clarify how much the degree of anti-competitiveness shall be prohibited. Thus it is difficult for firms to presume benefits from exemption. The only way to understand the degree of exemption criteria is to observe a case-by-case basis.<sup>11</sup> In particular, there is no sufficient guidance as to whether Article 3-2 or 23 should be applicable under current law, which may confuse practitioners. In the most recent cases, enterprises with a significant market share were not blamed for Article 3-2 violation. The reason is that the courts do not explicitly state the evidence of market share to decide whether an enterprise violated Article 23 or not. They implicitly assess market power of the enterprise as a crucial element in the case, only where its practice would make a certain enterprise bear business difficulties or create significant anti-competitive effects.<sup>12</sup> With regards to abuse of dominance in vertical cases, it is questionable why there are not many cases of application of Article 3-2 to refusal to deal. Article 3-2 would prevent more anti-competitive conduct at the vertical level. However, the KFTC is not keen to implement Article 3-2 rather than Article 23, for its convenience of catching all the possible infringement of competition law.<sup>13</sup> This has caused problems of application of law.

#### 4.2.2. Critical Assessment of Current Application of Article 23 MRFTA: *Coca-Cola*

A leading case of refusal to deal scrutinised under Article 23 MRFTA is *Coca-Cola, Co.* (present *Coca-Cola Korea Co.*, hereafter *Coca-Cola*).<sup>14</sup> In this case, the KFTC concluded that *Coca-Cola* infringed Article 23 for its refusal to deal with *Bumyang Co.* *Bumyang* was a Korean distributor of *Coca-Cola*. It had produced *Coca-Cola* products under the ‘bottler

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<sup>10</sup> Sec. V.1.B.(4) of the UBP Guidelines. Collective refusal to deal may also get a safety zone exemption under sec. V.1.A.(4) of the Guidelines.

<sup>11</sup> Jungwon Song, *Supra.*, note 8, p. 225.

<sup>12</sup> See Ho Young Lee, *Dok-Jum-Kyu-Jae-Bub-Ui-Ie-Ron-Kwa-Sil-Mu [Theories and Practices in Monopoly Regulation and Fair Trade Act]*, Hongmunsa, Seoul, 2006, p. 223.

<sup>13</sup> See Kwangshik Shin, *Innovating Korea's Competition Policy*, Nanam Publishing, Seoul, 2006, pp. 79-101.

<sup>14</sup> *Coca-Cola Korea Co.*, KFTC Decision 97-133, 9704Kyungchok0614, Aug. 27, 1997.

contract',<sup>15</sup> which allowed four Korean enterprises to produce and distribute the *Coca-Cola* product under a patent agreement since 1974. In 1991, *Coca-Cola* agreed to supply the cola syrup to *Bumyang* until 1996 without any further repeated extensions. Since 1993, *Coca-Cola* had tried to take over the assets of four domestic bottler contractors. However, *Bumyang* did not accept *Coca-Cola's* offer because of disagreement on the suggested price for the acquisition. Hence, *Coca-Cola* stopped supplying the cola syrup and trademark as required by the 1991 contract.<sup>16</sup> After *Coca-Cola* terminated *Bumyang's* distributorship, *Bumyang* requested the KFTC's investigation against *Coca-Cola* for its violation of Article 23. On appeal, the Seoul High Court affirmed the KFTC's decision, based on the rationale that *Coca-Cola* simply abused its position by seeking to obtain *Bumyang's* assets.<sup>17</sup> The High Court concluded that *Coca-Cola's* conduct was unlawful under Article 23, because it abused its position in refusing to supply, and created distortion of competition. The High Court based its holding on the fact established at trial that *Coca-Cola* terminated *Bumyang* in response to or following complaints about the take-over by *Coca-Cola*.

The Supreme Court, however, overruled the Seoul High Court's judgement, rooted in the reason that refusal to deal in itself does not infringe Article 23, because freedom of contract is the basic market principle.<sup>18</sup> The Court stated that a business practice which has a high possibility of driving out or impeding a certain enterprise's practice by the means of anti-competitive intention and its coercion from dominant position constitutes Article 23. In this case, however, the contract in 1991 clearly stated that the bottler agreement would expire in 1996 and would not be extended. *Bumyang* also established its own beverage company producing its own brand cola after disagreement over an acquisition negotiation with *Coca-Cola*. There was no sufficient evidence that *Bumyang* had no choice but to close its factory when *Coca-Cola* stopped supplying the product. In a word, although *Coca-Cola* did not supply cola syrup, *Bumyang* could still have produced its own product. Thus, *Coca-Cola's* refusal to deal was not enough to be blamed as unfair or anti-competitive because *Bumyang* had a capacity of beverage production despite discontinuity of supply. The Court corrected

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<sup>15</sup> This 'bottler contract' was an agreement between *Coca-Cola* and the domestic enterprises. *Coca-Cola* supplied beverage source for production, and the domestic manufacturers produced and supplied *Coca-Cola* in a certain area with a monopolistic position. See also Ho Young Lee, *Supra.*, note 12, p. 221.

<sup>16</sup> However, *Bumyang* could purchase the product source from *Coca-Cola* for the court procedure based on the KFTC decision until 1998.

<sup>17</sup> *Coca Cola Korea Co. v. KFTC*, Seoul High Court 97Ku53139, Oct. 1998.

<sup>18</sup> *Coca Cola Korea Co. v. KFTC*, Supreme Court 98Du17869, Jan. 5, 2001.

the judgment of the High Court by interpreting the meaning of competition law. The Court suggested following three conditions to satisfy Article 23 infringement regarding refusals to deal: (i) a high possibility of exclusion of ‘a certain enterprise’ resulting in difficulty of business practice; (ii) an intention of abuse of a dominant position, which is different from the meaning under Article 3-2; and (iii) a UBP by means of achieving a coercive contract. This judgment has influenced the KFTC to create a rule of reason examination under section V.1. of the UBP Guidelines.

In the *SKC Co. Ltd* case,<sup>19</sup> the Supreme Court also confirmed the judgment of the Seoul High Court, based on the grounds that there was no sufficient evidence that *SKC* ordered its agencies not to supply the relevant products. In the case, *SKC* supplied raw materials and manufactured final goods through its agencies. The KFTC examined whether *SKC* infringed Article 23 by forcing its agents to refuse to supply raw materials to its rivals competing in foreign markets. However, the Seoul High Court overruled the KFTC’s decision on the grounds that *SKC*’s competitors received the relevant goods from alternative suppliers without any difficulties, after its refusal to supply. Moreover, considering production capability of its competitors and market conditions, *SKC*’s refusal to deal did not infringe Article 23 because it did not prohibit competition in the market, nor impede the actual business practice of rivals. The courts looked at the effect and reality of the market structure and conditions. In *Hite Beer Co.*,<sup>20</sup> the Supreme Court also upheld that *Hite*’s refusal to deal did not satisfy the three conditions stated in the *Coca-Cola* case to be blamed as unfair. According to the case law, the courts seem to consider the real impact of refusal to deal and market conditions. The courts have defined the meaning of the terminology, unfairness, in Article 23. A mere refusal to deal cannot be blamed as anti-competitive practice but should satisfy the criteria.

This courts’ approach, however, still seems to focus on unfairness, rather than anti-competitiveness based on economic theories. In *E.I. du Pont de Nemours & Co. (DuPont*

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<sup>19</sup> *SKC Co. Ltd v. KFTC*, Seoul High Court 2000Nu1494, Jan. 30, 2001; Supreme Court 2001Du1628, Jun. 12, 2001.

<sup>20</sup> *Hite Beer Co. v. KFTC*, Seoul High Court 2002Du11059, July 9, 2004; Supreme Court 2005Du746, May 27, 2005.

*Korea*),<sup>21</sup> the Seoul High Court confirmed the KFTC's decision of *DuPont's* violation of Article 23. In this case, *DuPont's* sudden refusal to deal with its customer's competitor could inhibit competition in the domestic and also the Asian markets. The High Court stated that *DuPont's* refusal was, in effect, driving out a firm from the market, and the firm could not continue business because it would take at least one year to get alternative suppliers. This judgment seems to retreat towards unfairness-focus rather than economic principles, by emphasising the intent of driving out rivals. *DuPont* could have received benefits from objective justifications such as its lack of supply or unreasonable production for a certain firm at a loss. However, its argument was not granted and *DuPont* had to supply the relevant material despite incurring high costs. In conclusion, the courts have indicated that the three conditions should be met to attack refusal to deal under Article 23. Nonetheless, the rule of reason application was decided based on unfairness of the practice, without sufficient degrees of efficiency justification scrutiny from economics.

#### 4.2.3. Critical Assessment of Current Application of Article 3-2 MRFTA: *POSCO*

The overlapping problems in implementation of Articles 3-2 and 23 MRFTA, especially in refusal to deal cases, have long been regarded a confusion to competition lawyers. In particular, there has been debate whether a large firm has a duty to deal.<sup>22</sup> However, there was a noteworthy case based on presumption of market dominance. The *POSCO* judgment shows the current development of the case law by the courts.<sup>23</sup> In this case, *POSCO* was the sole manufacturer of hot coil in the domestic market with a 79.8 per cent market share.<sup>24</sup> *POSCO* refused to supply the relevant product to *Hyundai Hysco Co., Ltd*, its downstream level competitor, despite *Hysco's* several requests. Since *POSCO* possessed almost 80 per cent of market share and only 20 per cent of the goods were imported, the KFTC concluded that *POSCO* foreclosed the market and violated Article 3-2. In this case, Article 3-2 rather

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<sup>21</sup> *DuPont Korea*, KFTC Decision 2002-363, 2002*Kyoungchok*0588, Dec. 23, 2002, appealed, Seoul High Court 2003*Nu*11059, Nov. 25, 2004; Supreme Court 2005*Du*746, May 27, 2005. The Supreme Court affirmed the judgment of the Seoul High Court.

<sup>22</sup> E.g., *Youngil Chemical Corp.*, KFTC Decision 2001-22, 2000*Kyoungchok*0929, Jan. 11, 2001; *Royal Info Tech Corp.*, KFTC Decision 2006-221, 2005*Kyoungchok*2649, Oct. 10, 2006. *Youngil* case was the typical Art. 3-2 case of a refusal to supply raw materials regarding presumption of market dominance based on market share (54.6 per cent).

<sup>23</sup> *POSCO*, KFTC Decision 2001-068, 2001*Kyoungchok*0389, Apr. 12, 2001; *POSCO v. KFTC*, Seoul High Court, 2001*Nu*5370, Aug. 27, 2001; Supreme Court, 2002*Du*8626, Nov. 22, 2007.

<sup>24</sup> The relevant product was hot coil or hot rolled steel, the intermediary good, which was usually used for automotive parts production.

than Article 23 was applied since the KFTC relied on market share threshold under Article 4 MRFTA. It seemed to conclude this because *POSCO* was one of the large business groups, which had to bear the burden of ‘special responsibility’.<sup>25</sup>

*POSCO* appealed and argued as followings. Firstly, the hot coil product was not a final product but an intermediary one.<sup>26</sup> Therefore, the market definition of the KFTC was wrong. In addition, the geographic market should be defined as the Asian market rather than the domestic, because *Hysco* could import the product from other countries, such as Japan. Secondly, criteria of Article 3-2 violation under the Market Dominance Guidelines should be narrowed to a case of refusal to deal with an existing customer such as Article 23 enforcement. Because *POSCO* did not have a business relationship with *Hysco* before, it should not be blamed for Article 3-2 infringement. Thirdly, *POSCO* had not sold the intermediary hot coil products for automobile manufacture to any other enterprises before, and did not discriminate against *Hysco*. Finally, *POSCO*’s refusal to deal should be objectively justified based on the freedom of trade, and there was a sufficient reason to refuse to supply for its incapability of supplying products to *Hysco*.

The Seoul High Court however denied *POSCO*’s arguments by stating there were no objective justifications, based on the following reasoning. First, *POSCO* supplied hot coil products in the market for general purposes, which was an intermediary good, and had a similar characteristic to the hot coil for automotive parts. Therefore, the product market definition was correct. Second, the High Court interpreted that refusal to deal not only to existing consumers but also to an entrant to the market violates Article 3-2. Third, the appellant used to supply the relevant product to other enterprises but refused to supply to only *Hysco*, which constituted a discriminatory practice. Fourth, the appellant’s excuse for the scarcity of raw materials to supply could not be sufficient, based on the idea of special

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<sup>25</sup> See Bong Eui Lee, ‘Prohibition of Abuse of Market-Dominant Undertakings under the Monopoly Regulation and Fair Trade Act’, *Journal of Korean Law*, 2005, p. 70. The author argues that market dominant enterprises are said to have a special responsibility in the Korean market such as in the EC.

<sup>26</sup> Hot coil for general structure is slightly different from the hot coil for automotive parts in its usage. The former is produced for steel structures, bridges, ships, and automobiles, but the latter is solely used in automobile frames and wheels for its drawability and weldability. However, this technical argument was not deeply discussed.

responsibility.<sup>27</sup> This is because *Hysco* had to bear a significant cost and risk in importing the relevant product.

This High Court's judgment was, however, reversed by the Supreme Court, since *POSCO* had no abusive practices, although it had a market dominant position. The Court focused in the enquiry on whether the practice was unfair. The Supreme Court held that it is insufficient to acknowledge unfairness in all cases where a market dominant enterprise refuses a specific enterprise. Unfairness should be acknowledged only where a refusal to deal can be deemed as perpetrated with intent or the objective of maintaining or reinforcing monopolistic status at the market. Therefore, the KFTC had to prove that the enterprise had had the intent and objective to cause these outcomes, harming innovation or decreasing a number of competitors. The Court concluded that a mere disadvantage suffered due to the refusal to deal was not sufficient, and that the practice was not likely to prohibit competition because *Hysco* could satisfy its demand through imports.

This was a landmark judgement since the Court finally defined the scope of application of Article 3-2 and meaning of unfairness. The high market share does not, itself, infringe the law despite its special responsibility. The KFTC should not consider denial of access with market power as per se unlawful, and impose duty to deal that it cannot explain or adequately and reasonably supervise.<sup>28</sup> In this case, the Court affirmed that the principle of a market economy is to guarantee the freedom of business activities. The courts and the KFTC, however, still need to refine the application of Articles 3-2 and 23. The lack of sufficient criteria of examining practices has created legal uncertainty. If the KFTC established clear market share threshold guidance, it would be better to apply the relevant provision to refusal to deal. It would be, then, easy for the courts to examine whether the refusal to deal creates more pro-competitive than anti-competitive effects. Moreover, the courts can scrutinise better the real impact of the practice on the market. In addition, they can establish the application of the rule of reason in refusal to deal by examining pro-competitiveness rather than unfairness.

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<sup>27</sup> This is the influence of the EC regime, e.g., Case 322/81, *NV Nederlandsche Banden-Industrie Michelin v. Commission* [1983] ECR 3461.

<sup>28</sup> See Phillip Areeda, 'Essential Facilities: An Epithet in Need of Limiting Principles', *Antitrust Law Journal*, Vol. 58, 1989, pp. 852-853. The author illustrates some principles that should limit application of the essential facilities concept in the US courts. This may have somewhat influenced the Korean courts.

### 4.3. Tie-in Sales<sup>29</sup>

#### 4.3.1. Critical Assessment of Current Application of Article 23 MRFTA: *Korea Land*

A tying arrangement exists when a producer sells a product only to those who also buy a second product from it. It might foreclose other sellers of the tied product from an opportunity to compete.<sup>30</sup> The KFTC normally recognises tying as a violation under Article 23 rather than 3-2. Article 23 works as a catch-all provision without consideration of market dominance, although tying is theoretically considered as a violation of law, as an abuse of market dominance in other competition regimes.<sup>31</sup> Section 5(1) of the Enforcement Decree Appendix 1 categorises tie-in sales as the type of coercion in dealing under Article 23.<sup>32</sup> It defines tie-ins as forcing wrongfully to purchase goods or services.<sup>33</sup> The KFTC scrutinises market power of an enterprise, distinctiveness of the products, and consumers' behaviour in order to decide whether the practice is anti-competitive.<sup>34</sup> To prove the existence of an illegal tying arrangement, the following conditions should be then examined: (i) two separate products;<sup>35</sup> (ii) sufficient market power in the tying market; (iii) influence on substantial amounts of commerce in the tied good market; (iv) evidence of coercion;<sup>36</sup> and (v) anti-competitive effects.<sup>37</sup> The KFTC seems to adopt these criteria applied in the US.<sup>38</sup>

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<sup>29</sup> Bundling is similar to tying. However, this is a looser concept if an enterprise provides products together in a bundle but also sells at least some of the products separately as well. Therefore, only pure bundling can be regarded as tying.

<sup>30</sup> See Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Antitrust Analysis: Problems, Text, and Cases*, 6th edn, Aspen Publishing, New York, 2004, p. 587.

<sup>31</sup> See Hwang Lee, 'Tying Arrangement as a Kind of Unfair Trade Practices: Discussions About A Recent Case', *Journal of Korean Competition Law*, Vol. 14, 2006, p. 247.

<sup>32</sup> The second half of subpara. 3 of Art. 23(1) MRFTA.

<sup>33</sup> Some scholars argue that this coercion element should not be applied in franchise tying. See Alan Meese, 'Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts', *Michigan Law Review*, Vol. 95, No. 1, 1996, pp. 160-61.

<sup>34</sup> Sec. V.5.A.(1) of the UBP Guidelines.

<sup>35</sup> *Ibid.*, sec. V.5.A.(1)(A). Regarding technological innovation or new product markets, the KFTC shall consider overall present technological innovation and market conditions, but it is hard to observe a relevant case regarding this at this moment. See also Jungwon Song, *Supra.*, note 8, p. 334.

<sup>36</sup> This coercion to purchase products is the crucial element in tying litigation. This approach can be also seen in the US cases, *Atlantic Ref. Co. v. FTC*, 381 U.S. 357, 370, 375-376 (1965); *FTC v. Texaco*, 393 U.S. 223, 228-229 (1968). See also Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 30, p. 601.

<sup>37</sup> For general arguments about criteria, see also Benjamin Klein and Lester Saft, 'The Law and Economics of Franchise Tying Contracts', *Journal of Law and Economics*, Vol. 28, 1985, p. 345; Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, 3rd edn, Thomson West, St. Paul, MINN, USA, 2005, pp. 397-8.

<sup>38</sup> See Seung-Wha Chang, 'Violation Criteria of Tying under the Monopoly Regulation and Fair Trade Act', *Seoul University Law Journal*, Vol. 45, No. 4, 2004, p. 503.



In practice, evidence of coercion is the crucial element in Korea. To examine this, the KFTC questions whether a consumer may purchase the products or services separately.<sup>39</sup> The KFTC also considers normal commercial practices<sup>40</sup> and market power, including its anti-competitiveness and unfairness. A tie-in conduct is not considered as anti-competitive itself where its commercial method is regarded as reasonable.<sup>41</sup> If a tie-in sale is considered as common practice and does not create any potential anti-competitive effect or reduction of consumer welfare, it will not be regarded as violation. However, the view that tying contracts allow the wielding of monopolistic leverage is widely accepted, although wielding monopolistic leverage is an ambiguous phrase in the Korean market.<sup>42</sup>

Despite some tying decisions of the KFTC, there have not been enough court judgments to guide whether the KFTC's implementation is correct. Therefore, enterprises have problems in how far they can practice tying and not be found in infringement. A current judgment of the Supreme Court, however, established the criteria of violation of tying. In the *Korea Land Corp.* case,<sup>43</sup> the enterprise was the real estate company which used to be a state corporation. *Korea Land* tied two different areas, one of which was popular, but another which was not when sold together to construction companies. The KFTC decided that *Korea Land* had a significant market share, 40 per cent, and this power made the construction companies purchase unpopular land in order to obtain the desired one. The Seoul High Court confirmed the KFTC decision that *Korea Land* infringed Article 23 for its tying practice. The Supreme Court also affirmed the High Court's judgment, based on the market power of the appellant and unfair methods of business activity by tying.

The Court reasoned it was not plausible to expect economic efficiency justifications from this tying practice, which might be created in other industries such as research and development (R&D), or technological products, since this practice was a simple tying of popular and unpopular properties. *Korea Land* merely coerced construction companies to buy

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<sup>39</sup> E.g., *Korea Land Corp. v. KFTC*, Seoul High Court 2001Nu16288, Feb. 2004.

<sup>40</sup> E.g., *Carrefour Korea Co.*, KFTC Decision 97-51, Feb. 26, 1997.

<sup>41</sup> See Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsa, Seoul, 2005, p. 355.

<sup>42</sup> This seems the influence from the US. See Ward Bowman, Jr., 'Tying Arrangements and the Leverage Problem', *The Yale Law Journal*, Vol. 67, No. 1, 1957, pp. 19-20.

<sup>43</sup> *Korea Land Corp. v. KFTC*, Seoul High Court 2001Nu16288, Feb. 10, 2004; Supreme Court 2004Du3014, Mar. 24, 2004. The KFTC established the criteria of tying violation in *OBC Gram Corp.*, KFTC Decision 92-124, 9209II438, Oct. 22, 1992. However, the confirmed set of criteria was made in *Korea Land*.

these together, which was considered unfair. The Court's judgment made it clear by confirming criteria for infringement as illustrated above, adding one more condition. A tying practice should be considered unfair in light of sound market practices, and questioned whether consumers were deprived excessively of opportunities to make free choices.<sup>44</sup> This judgment focused on unfairness by examining the restraint of freedom of choice rather than efficiency, which may also improve consumer welfare.<sup>45</sup> It is difficult to define what unfairness means. This clause seems to protect competitors or customers rather than competition.

In the case of foreclosure through tying, a firm may continue to earn the full monopoly profits and also achieve a dominant position. Efficient rival enterprises will not be able to enter the market.<sup>46</sup> However, tying practices may also improve inter-brand competition, reduce transaction costs,<sup>47</sup> and eliminate free-riding and deterioration in the reputation of franchises,<sup>48</sup> despite anti-competitive effects such as foreclosure or entry barriers. Therefore, competition authorities should trade-off the anti- and pro-competitive effects. However, this issue was not discussed fully in the courts. Furthermore, the conditions of market power in tying violations are not clear. It is also unclear whether the authority needs to set another condition to distinguish Article 3-2 and 23 enforcements. To infringe Article 3-2 MRFTA, the firm should satisfy the criteria of Article 4 MRFTA. Nonetheless, the MRFTA does not clearly explain what the minimum level of market dominance is in order to apply Article 23 in a tying case. This problem has again caused overlapping issues in Articles 3-2 and 23, which may confuse the courts and lawyers,<sup>49</sup> as has happened recently.

#### 4.3.2. Critical Assessment of Current Application of Article 3-2 MRFTA: *Microsoft*

There was also a significant KFTC decision on a tie-in practice taken after the Supreme Court's Article 23 judgment which eventually brought up the overlapping problem. The KFTC found that *Microsoft Corp.* infringed both Articles 3-2 and 23 based on the fact that it

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<sup>44</sup> For further details, see Hwang Lee, *Supra.*, note 31, p. 284.

<sup>45</sup> Ho Young Lee, *Supra.*, note 12, p. 255.

<sup>46</sup> See Barry Nalebuff, 'Exclusionary Bundling', *The Antitrust Bulletin*, Vol. 50, No.3, 2005, p. 327.

<sup>47</sup> In many cases, consumers are interested in the package or assembled product rather than individual parts and components, which reduces transaction costs. See ABA, *Antitrust Law and Economics of Product Distribution*, ABA Publishing, Chicago, 2006, p. 192.

<sup>48</sup> Alan Meese, *Supra.*, note 33, p. 119.

<sup>49</sup> E.g., *SK Telecom Corp.*, KFTC Decision 2007-044, 2006Sokyoung0785, Feb. 6, 2007.

ties (i) Windows server system and Windows Media Service, (ii) Windows XP and Windows Media Player, and (iii) Windows XP and MSN.<sup>50</sup> The KFTC decided that *Microsoft* coerced consumers to buy other products by abusing its dominant position in the Windows PC system market, and restricted consumers' choice to have a better quality product.<sup>51</sup> Moreover, *Microsoft* impeded competition by tying and drove out its rivals by establishing entry barriers. This decision was similar to that of the EC. The Court of First Instance (CFI) affirmed the findings by the EC Commission that *Microsoft* abused its dominance and violated Article 82 EC.<sup>52</sup> The major findings of violation in Korea and the EC were, therefore, that *Microsoft* made its own media player and bundled it with its operating system, effectively foreclosing its rivals from the market.<sup>53</sup>

The KFTC examined whether the efficiency benefits outweighed anti-competitive effects, and it concluded that *Microsoft's* practice did not create a considerable efficiency-improvement. This KFTC's approach seemed to follow the criteria in *Korea Land*. Its rationale was that tying can be used to preserve a monopoly position in the tying market by deterring the entry of efficient suppliers as stated in *Korean Land*, although the *Microsoft* case was different, dealing with technological products in the new economy.<sup>54</sup> *Microsoft* argued that its tying could create a significant efficiency from reducing transaction costs of distribution, improving other software programmes, thereby benefiting service providers and consumers. However, the KFTC denied these arguments, based on two main reasons. First, transaction costs could be reduced by installation of other media players or messenger programmes. Moreover, a transaction cost of software distribution is trivial nowadays. Thus, in the PC market, the transaction cost reduction should be ignored. Second, applied software

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<sup>50</sup> *Microsoft Co.*, KFTC Decision 2006-042, 2002Kyoungchok0452 and 2005Kyoungchok0375, Feb. 24, 2006. The KFTC ordered *Microsoft* to unbundle tied products and to install Media Centre and Messenger Centre, through which download links to competitors' products are provided, with a surcharge of 32.49 billion KRW.

<sup>51</sup> For further discussion about consumer choice and quality disputes, see Benjamin Klein and Kevin Murphy, 'Vertical Restraints as Contract Enforcement Mechanisms', *Journal of Law and Economics*, Vol. 31, No. 2, 1988, pp. 266; Robert Lande, 'Consumer Choice As The Ultimate Goal of Antitrust', *University of Pittsburgh Law Review*, Vol. 62, 2001, pp. 511-4; ABA, *Supra.*, note 47, pp. 193-4.

<sup>52</sup> *Microsoft Corp v Commission*, Case T-201/04, [2007] ECR II-000, [2007] 5 CMLR 846. For further discussion, see Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, USA, 2006, pp. 496-500.

<sup>53</sup> See Eleanor Fox, 'Competition Law' in Andreas Lowenfeld, *International Economic Law*, 2nd edn, Oxford University Press, Oxford, 2008, p. 436.

<sup>54</sup> See Denis Carlton and Michael Waldman, 'The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries', *The RAND Journal of Economics*, Vol. 33, No. 2, 2002, pp. 150-51; Barry Nalebuff, 'Bundling as an Entry Barrier', *The Quarterly Journal of Economics*, Vol. 119, 2004, p. 183. However, the authors argue that the use of tying to preserve a monopoly position will be most important in industries characterised by substantial innovation where product lifetimes are short.

programme development from tying could have been also made where another enterprise tied *Microsoft* products with its own products.

The KFTC's rationale was not fully examined objectively. There were no sufficient data of transaction costs in software distribution, and it would thus be difficult to find whether the transaction cost reduction was trivial or not. Moreover, the assumption of tying *Microsoft* products with other firms' products cannot be made normally in practice. Therefore, the decision was correct but the reasoning was wrong. It would be more rational if the KFTC had concluded that this was the dominant firm's strategy of remaining dominant in a software industry undergoing rapid technological change in a newly emerging market, rather than mere tying based on non-plausible grounds. *Microsoft* could preserve its market power in the primary market.<sup>55</sup> This tying could make the prospects of successful entry less certain, by discouraging rivals from investing and innovating. This practice might reduce consumer and total economic welfare.<sup>56</sup> However, this anti-competitive rationale, based on economics, was not discussed.

In addition, this decision was very remarkable in its application of both Articles 3-2 and 23. The KFTC had never applied both provisions to a single case before. However, this decision proved that the KFTC can be confused in application of law, since there is no clear guidance of distinction for application. This implementation can be compared with that of the Japan Fair Trade Commission (JFTC). The AML contains two provisions for tying practices: monopolisation clause under the first half paragraph of Article 3 AML, and UBP clause under Article 19. The monopolisation clause basically follows the section 2 of the US Sherman Act. The UBP clause inherited unfair methods of competition, again, the US Federal Trade Commission (FTC) Act, section 5. The US FTC has for years been applying section 5 of the FTC Act in a manner consistent with section 2 of the Sherman Act. In contrast, the JFTC and the KFTC have maintained UBP standards as being distinct from monopolisation standards, and thus more flexible. For the most cases, the JFTC, like the KFTC, applies the UBP clause rather than monopolisation. This legal provision can be applied to most enterprises that are lacking market power. However, it is not always the case. For example,

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<sup>55</sup> *Ibid.*, Dennis Carlton and Michael Waldman, pp. 209-16.

<sup>56</sup> See Jay Pil Choi and Christodoulos Stefanadis, 'Tying, Investment, and the Dynamic Leverage Theory', *The RAND Journal of Economics*, Vol. 32, No. 1, 2001, pp. 52-4.

the Japanese case concerning *Microsoft*<sup>57</sup> had market power but UBP provision was applied. Some critics argue that the JFTC had to apply the globally accepted monopolisation clause rather than the easier Japanese UBP rule.<sup>58</sup> By comparison with the EC and the JFTC, the KFTC's decision was unclear as to whether its application of both provisions was justifiable. Because there is no clear judgment of the courts, it will be a controversial matter. However, the KFTC should have applied only one of the provisions in the *Microsoft* case, and it had to be Article 3-2 rather than 23.

#### 4.3.3. Critical Assessments in Tie-in Sale Cases from Economic Debates

In the US, illegal tying by a dominant firm has been easier to prove, because it has been subject to a modified per se rule. Plaintiffs prevail upon proof that the defendant had significant market power over the tying product, that it used this power to force buyers to accept a tied product, and that the tying involves a significant amount of commerce. This modified per se rule dispenses with the need to prove that competition in the tied product is distorted.<sup>59</sup> In other words, a monopolist can leverage their monopoly power into another market and raise prices above the competitive level in the second market. The major competition law concern about tying is, therefore, whether a monopolist uses its market power in the tying product market to increase its power in the other markets.<sup>60</sup> However, there are several potential pro-competitive benefits from tie-ins: (i) enhancing market entry; (ii) maintaining quality reputations;<sup>61</sup> and (iii) improving producers' informational flow on technologically sophisticated products.<sup>62</sup>

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<sup>57</sup> In *Microsoft Japan*, JFTC Decision, Dec. 14, 1998, *Shinketushu* 45-153, the JFTC found that the firm had violated UBP provision rather than Art. 3 AML for its tying license of the word processing software and the license of scheduler. For further detail, see Masako Wakui, *Antimonopoly Law: Competition Law and Policy in Japan*, Arima Publishing, Suffolk, 2008, pp. 146-7.

<sup>58</sup> See Toshaki Takiagawa, 'A Comparative Analysis of U.S., EU, and Japanese Microsoft Cases: How to Regulate Exclusionary Conduct by a Dominant Firm in a Network Industry', *The Antitrust Bulletin*, Vol. 50, No. 2, 2005, p. 261.

<sup>59</sup> Eleanor Fox, *Supra.*, note 53, p. 435.

<sup>60</sup> See Simon Bishop and Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, Sweet & Maxwell, London, 2000, 109-11; Keith Hylton, *Antitrust Law: Economic Theory and Common Law Evolution*, Cambridge University Press, Cambridge, 2003, pp. 279-81.

<sup>61</sup> See Richard Posner, 'The Chicago School of Antitrust Analysis', *University of Pennsylvania Law Review*, Vol. 127, 1979, p. 927.

<sup>62</sup> See Lawrence Sullivan and Warren Grimes, *The Law of Antitrust: An Integrated Handbook*, 2nd edn, Thomson West, St. Paul MINN, USA, 2006, p. 426.

There are additional explanations of benefits from tying. Tying can be used by enterprises producing a wide variety of products and services, and used to sell products at the distribution level. The widespread use of tying by enterprises in highly competitive markets suggests that tying yields benefits for both enterprises and consumers. Tying can be also used as a means to reduce the transaction costs involved in purchasing, distributing, and selling goods and services. It can enable enterprises to achieve economies of scale or scope in production and distribution, and allow them to package and market integrated and compatible products to consumers. Moreover, tied products can be cheaper to produce or distribute together, or can be more valuable to the consumer if the supplier bundles them than if the consumer does.<sup>63</sup>

In a market where enterprises can exercise monopoly power, tying can have anti-competitive uses. If tying can generate efficiency-promoting functions, it could also promote the anti-competitive functions associated with such practices. The pursuit of profit-maximising goals by a firm with market power can be, however, inconsistent with consumers' interest,<sup>64</sup> and this brought the KFTC's concerns about consumer protection in *Microsoft*. Tying can be also a means of raising prices for the tied package or of being an entry barrier,<sup>65</sup> which is one of the major concerns of the KFTC. Because tying can be an efficient practice in spite of market power, any rational competition evaluation of tying must simultaneously consider both the strategic anti-competitive and efficiency reasons for its use.<sup>66</sup> Tying can be also used not just to extend market power into tied markets, but also to preserve and create market power in the tying market and newly emerging markets. In other words, tying can be one of the tools the firm employs to retain market dominance. To summarise, the welfare implication of tying is, in general, ambiguous. Therefore, there seems to be a consensus emerging amongst economists that tying should not be treated as violation

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<sup>63</sup> See Einer Elhauge and Damien Geradin, *Global Competition Law and Economics*, Hart Publishing, Oxford, 2007, pp. 504-5.

<sup>64</sup> See Eleanor Fox, 'The Modernization of Antitrust: A New Equilibrium' in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, pp. 272-3. The author argues that a view of efficiency defined by business autonomy is inappropriate for competition policy.

<sup>65</sup> See John Kwoka and Lawrence White (eds), *The Antitrust Revolution: Economics, Competition, and Policy*, 4th edn, Oxford University Press, New York, 2004, p. 327.

<sup>66</sup> Keith Hylton, *Supra.*, note 60, pp. 283-4; Robert Hahn, 'Introduction' in Robert Hahn (ed), *Antitrust Policy and Vertical Restraints*, AEI, Washington D.C., 2006, p. 12. The Chicago and Post-Chicago Schools' explanations also apply with equal force to the use of tying by enterprises with market power. Enterprises with market power can use tying for other reasons, for example, as a price discrimination device or a way to internalise pricing externalities in the presence of complementary goods.

per se, and the competition authorities should balance possible efficiency effects against potential anti-competitive ones.<sup>67</sup> If a firm does not have market power, its tie-in practices should not be blamed for violation of the law. Nevertheless, the KFTC and courts do not establish the most important criteria for tie-in enforcement. Since tying by a firm without market dominance cannot create anti-competitive effects, the KFTC needs to sufficiently examine whether there are any leverage effects. For instance, in the *Wedding Blanc* case,<sup>68</sup> although the KFTC recognised the enterprise's market power was not very significant in leveraging its power into another market, and there was no lock-in effect, it simply decided its tying wedding service with make-up and dress rental infringed Article 23. The KFTC should change its current approach. It should keep Article 3-2 for preventing anti-competitive tying practices, and withdraw the tying clause in Article 23. Besides, the courts should examine tying cases based on economics rather than fairness. Then, the courts can better develop the rule of reason.

#### 4.4. Exclusive Dealing and Territorial Restriction

##### 4.4.1. Transaction Based upon Restrictive Conditions under Article 23 MRFTA

Section 7 of the Enforcement Decree Appendix 1 defines the prohibition on anti-competitive unfair practices based on restrictive conditions as exclusive dealing and territorial restriction. Because the MRFTA defines these as one category of enforcement, these practices will be discussed together. It explains that this type of restriction is as stipulated in the first half of subparagraph 5 of Article 23(1) MRFTA. Article 3-2 MRFTA also prohibits these. However, there have been fewer cases under Article 3-2 than Article 23.<sup>69</sup> The MRFTA prohibits exclusive dealing as establishing conditions of not trading with competitors, including potential entrants. The KFTC investigates exclusive dealing under UBP Guidelines as to

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<sup>67</sup> Denis Carlton and Michael Waldman, *Supra.*, note 54, p. 197; Jay Pil Choi, 'Antitrust Analysis of Tying Arrangements' in Jay Pil Choi (ed), *Recent Developments in Antitrust: Theory and Evidence*, The MIT Press, Cambridge MA, USA and London, 2007, p. 81.

<sup>68</sup> *Wedding Blanc*, KFTC Decision 2007-057, 2006Busa1966, May 26, 2007.

<sup>69</sup> There are some Article 3-2 cases of exclusive dealing, e.g., *Korean Air Lines Co., Ltd.*, KFTC Decision 90-14, July 6, 1990; *Dongyang Beer Co.*, KFTC Decision 93106, 9306Dok343, July 22, 1993; *Korea Tobacco and Ginseng Co., Ltd.*, KFTC Decision 98-51, Mar. 11, 1998. For further details about the cases, see Ohseung Kwon, *Supra.*, note 41, pp. 173-4.

whether the practice creates vertical foreclosure.<sup>70</sup> It also examines the enterprise's market share, the number of competitors, the period of exclusive dealings, and its combination with other vertical restraints with exemption conditions. The UBP Guidelines thus provide objective justifications that exclusive dealing does not violate competition law where it is necessary to maintain its technical and specialised character of goods and services, or to improve inter-brand competition and enhance consumer welfare. Moreover, if an enterprise provides obvious evidence of preventing free-riding and creating efficiency, its practice will be justified under the rule of reason.<sup>71</sup> With regards to territorial restriction, the KFTC also examines improvement of inter-brand competition and investigates it by the rule of reason. As in exclusive dealing provisions, the KFTC shall scrutinise the market share and number of competitors in the market, considering this in combination with anti-competitive activities such as RPM and other non-price restraints.<sup>72</sup>

The KFTC relies on market share as one of the important measures for deciding market power in these restraints. Although some scholars argue that the KFTC does not regard market share as crucial, market share threshold tests seem to function as the foremost measure for scrutiny for UBP enforcement. The KFTC also considers overall vertical foreclosure effects and possibilities of excluding competitors.<sup>73</sup> However, there have not been enough cases to consider the KFTC's consistent decision-making for these types of restraint.<sup>74</sup> Some commentators criticise the UBP Guidelines for only listing the criteria of exemption which may result in strait-jacket effects. Therefore, the KFTC should refer to other competition regimes' cases, and also consider market power of enterprises through apprehensible market definition<sup>75</sup> and degree of entry barriers.<sup>76</sup> However, it is burdensome for the KFTC to define the relevant market in every UBP case. It seems to create significant administrative costs whenever the KFTC has to do a clear market definition for applying Article 23.<sup>77</sup> Whether it is appropriate to use market share as a proxy for market power

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<sup>70</sup> Sec. V.7.A.(2) of the UBP Guidelines.

<sup>71</sup> Sec. V.7.A.(2)(C) of the UBP Guidelines.

<sup>72</sup> Secs. V.7.B.(2) and (3) of the UBP Guidelines.

<sup>73</sup> E.g., sec. V.7.B.(4) of the UBP Guidelines, examples of violation.

<sup>74</sup> Jungwon Song, *Supra.*, note 8, pp. 424-6.

<sup>75</sup> E.g., *Muhak and Daesun Distilling v. KFTC*, Seoul High Court 2003Nu2252, Oct. 27, 2004.

<sup>76</sup> Jungwon Song, *Supra.*, note 8, p. 429.

<sup>77</sup> E.g. *Interpark G Market Corp.*, KFTC Decision 2007-555, 2006Sukyoung4846, Dec. 18, 2007. The firm argued that the market definition was wrongful in the KFTC's narrow definition of the internet open market.



strongly depends on the quality of definition of the relevant market,<sup>78</sup> and it is riskier for the KFTC to lose in the appeal court than not provide a good definition. Furthermore, there are many criticisms against this unclear practice of a 10 per cent safety zone for exemption. Some commentators argue that the KFTC should increase the market share threshold to 30 per cent as applied in the EC, or 25 per cent as in most US courts.<sup>79</sup> Therefore, the KFTC has two tasks, developing market definition and clear market share threshold.

#### 4.4.2. Exclusive Dealing as Transaction of Restrictive Condition: *Korean Air Lines*

Exclusive dealing is a contract between a supplier and a buyer forbidding the buyer from purchasing a contracted good from any other seller, or requiring the buyer to place all of his needs in the contracted product.<sup>80</sup> This can be defined as a contractual requirement by which retailers or distributors promise a supplier that they will not handle the goods of competing producers.<sup>81</sup> Such agreements have possible anti-competitive effects, such as increasing the credibility of the threat to exclude rivals and entry deterrence,<sup>82</sup> despite possibly promoting efficiency.<sup>83</sup> One frequently cited motive for exclusive dealing is also the desire to create or enhance market power.<sup>84</sup> The *Korean Air Lines Co., Ltd (KAL)* case demonstrates the KFTC's approach to exclusive dealing, from these concerns.<sup>85</sup> When *KAL* started a new marketing scheme, a mileage service called *Sky Pass*, it made agreements with credit card companies to increase and maintain its market share, which was slightly over 50 per cent of the domestic airline market.

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<sup>78</sup> See Luc Peeperkorn and Vincent Verouden, 'The Economics of Competition' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, Oxford University Press, Oxford, 2007, p. 58.

<sup>79</sup> Jungwon Song, *Supra.*, note 8, p. 440.

<sup>80</sup> See Phillip Areeda and Herbert Hovenkamp, *Fundamentals of Antitrust Law, Vol. II*, Aspen Law & Business, New York and Gaithersburg, 2002, p. 835.

<sup>81</sup> See Howard Marvel, 'Exclusive Dealing', *Journal of Law and Economics*, Vol. 25, No. 1, 1982, p. 1.

<sup>82</sup> See William Comanor and Harry Frech III, 'The Competitive Effects of Vertical Agreements?', *The American Economic Review*, Vol. 75, No. 3, 1985, p. 544.

<sup>83</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 63, p. 454. This can be observed in utility markets, e.g., *Hanaro Communications Corp.*, KFTC Decision 2002-001, 2001Dokjom2656, Jan. 5, 2002; *Thrunet Corp.*, KFTC Decision 2002-002, 2001Dokjom2658, Jan. 5, 2002.

<sup>84</sup> See Douglas Bernheim and Michael Whinston, 'Exclusive Dealing', *The Journal of Political Economy*, Vol. 106, No. 1, 1998, p. 77.

<sup>85</sup> *Korean Air Lines Co., Ltd*, KFTC Decision 2000-79, 2000YuGoe0018, May 25, 2000. There were similar cases of exclusive dealing through membership systems, e.g., *Shinsegi Communications Corp.*, KFTC Decision 2001-123, 2001Dokjom1510, Aug. 23, 2001; *SK Telecom Corp.*, KFTC Decision 2001-127, 2001Dokjom1507, Sept. 10, 2001.

*KAL* then prevented its coordinating credit card enterprises from making a similar mileage plan with its competitor, *Asiana Airlines Inc.* *KAL* made an agreement with *Samsung Card Co.* with the condition that *Samsung* would terminate its business with *Asiana*. It also stopped a coordinated plan with *Kookmin Card Co.*, and notified termination of an agreement with *Korean Exchange Bank Card Ltd* when these firms entered agreements with *Asiana* on a mileage scheme. The KFTC found that *KAL* infringed Article 23 for excluding and trying to drive out its rival from the market by exclusive dealing agreements. In fact, *KAL* had a slightly larger market share than its sole domestic competitor, *Asiana*; thus the domestic market was duopolistic. However, the KFTC reasoned that, because *KAL*'s market share was bigger, it was assumed to be a market leader. It stated that credit card companies which would make a coordination scheme with an airline had to choose *KAL* as a business partner in order to induce more customers.

What competition laws should strive to do is to achieve economic efficiency through the process of competition.<sup>86</sup> Merely having a greater number of competitors does not necessarily aid the process of competition. It is competition's role to drive prices towards marginal costs, achieving greatest output with the least input. Therefore, even two competitors, as seen in this case, who are competing fiercely and have the capacity to increase services or products, will achieve these benefits. More competitors are not necessarily needed to keep the process of competition working effectively, because competition and free entry should promote efficiency and prosperity.<sup>87</sup> Thus, the KFTC wrongfully decided that *KAL*'s exclusive dealing was anti-competitive. Furthermore, it mistakenly concluded there would be a high probability that the number of potential customers using this mileage service would increase in the near future, although the data indicated only 10 per cent of customers used the coordinated card mileage service at the time of investigation.

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<sup>86</sup> See Robert Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division', *The Yale Law Journal*, Vol. 74, No. 5, 1965, p. 831; David Gerber, 'Competition Law', *The American Journal of Comparative Law*, Vol. 50, 2002, p. 272. The authors explain that competition is the name of process.

<sup>87</sup> See Philippe Aghion and Rachel Griffith, *Competition and Growth: Reconciling Theory and Evidence*, The MIT Press, Cambridge MA, USA and London, 2005, p. 1; Ky Ewing, Jr., *Competition Rules for the 21st Century: Principles from America's Experience*, 2nd edn, Kluwer Law International, Alphen aan den Rijn, The Netherlands, 2006, pp. 210-11.

This decision was wrong because there was no evidence of unreasonably preventing competition, thereby harming consumers. Although the KFTC did not describe the lock-in effect to conclude exclusive dealing in this case, it seemed to apply the theories of potential entry barriers<sup>88</sup> and locking-in consumers to choose *KAL* and its credit card companies.<sup>89</sup> The exclusive dealing practice of *KAL* could create vigorous competition rather than inhibit competition. The KFTC did not fully consider the effect of the practice. It did not consider that consumers use international travels to increase mileage points, rather than domestic flight. Furthermore, although *Asiana* could have alternative credit card enterprises, the KFTC concluded that *KAL*'s practice could foreclose the market and prove unfair. In this case, the KFTC moreover wrongfully applied Article 23 rather than Article 3-2, although *KAL*'s market share satisfied the presumption of market dominance.

This Korean case can be compared with the recent US case, *Dentsply*<sup>90</sup> regarding foreclosure and pro-competition problems. A manufacturer of artificial teeth, *Dentsply*, with a 75-80 per cent market share, entered into exclusive dealing contracts with its dealers, who sold *Dentsply* teeth with other suppliers to dental labs. The US Department of Justice (DOJ) challenged the contracts under sections 1 and 2 of the Sherman Act, maintaining that exclusivity had a foreclosure effect with no pro-competitive rationale. On appeal, the district court rejected *Dentsply*'s attempt to provide pro-competitive justifications for its exclusive dealing, but did not condemn the arrangements on either section 1 or 2, because sufficient alternative distribution channels were available for rivals. However, the Court of Appeal reversed the district court's rejection of section 2 antitrust liability, concluding that *Dentsply* effectively foreclosed the preferred distribution channels without a valid pro-competitive rationale. *Dentsply* illustrated the narrow economic foundation of pro-competitive justifications such as free-riding and incentive of promotion of products.<sup>91</sup>

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<sup>88</sup> E.g., *Kangwon Land Corp*, KFTC Decision 2002-038, 2001Dokwan1673, Jan. 17, 2002. The KFTC emphasised entry barrier based on its *ex ante* analysis in the exclusive supplying slot machines.

<sup>89</sup> For further discussion about raising rivals' costs, see Steven Salop and David Scheffman, 'Raising Rivals' Costs', *The American Economic Review*, Vol. 73, No. 2, 1983, pp. 267-71; Thomas Krattenmaker and Steven Salop, 'Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price', *The Yale Law Journal*, Vol. 96, No. 2, 1986, pp. 230-49.

<sup>90</sup> *United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d at 387 (D. Del. 2003), *rev'd*, 399 F.3d 181 (3d Cir. 2005), *cert. denied*, 126 S.Ct. 1023 (2006).

<sup>91</sup> See Benjamin Klein and Andres Lerner, 'The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty', *Antitrust Law Journal*, Vol. 74, No. 2, 2007, pp. 474-6.

Some commentators criticise this judgment. In this case, the absence of any pro-competitive rationale for exclusivity led the court to condemn the contracts, and this rationale worked as in *KAL*. In *KAL*, there was no really harmful impact of the large market share on the domestic airlines competition. There was, furthermore, a possible pro-competitive rationale for its exclusive dealing contracts, hence increasing vigorous competition which may result in better services to consumers. The US and Korean competition regimes rejected a rationale for exclusive dealing, emphasising the lack of evidence of pro-competition or efficiency grounds.<sup>92</sup> In *KAL*, the authority did not consider inter-brand competition through exclusive dealing, and heavily focused on a large market share without consideration of vigorous competition. However, the big difference between these two cases is that the KFTC did not discuss pro- and anti-competitive effects based on economics, but came to its conclusion based on unfairness.

#### 4.4.3. Territorial Restriction as Transaction of Restrictive Condition: *Domino Pizza*

Territorial restriction is another example of a vertical restraint that can give a downstream firm an incentive for greater investment in brand-specific practices that will enhance the brand's competitive position.<sup>93</sup> In a territorial restriction scheme, a manufacturer divides marketing areas into districts, agreeing with distributors in each district not to permit his product to be distributed by anyone else, having a monopoly position within the specified territory.<sup>94</sup> If a dominant firm has this scheme, it certainly infringes Article 3-2. This can be observed in the *Hyundai Motors*<sup>95</sup> which restricted business territories of its distributors. However, this type of practice is mostly examined under Article 23. Hostility towards territorial restrictions under Article 23 emerged in *DPK International Co., Ltd (Domino Pizza franchisor)*.<sup>96</sup> *Domino* restricted the territories within which its franchisees could sell. *Domino* restricted its franchisees' area of pizza delivery and warned its franchisees not to offer delivery services beyond the appointed areas. The KFTC stated that the market share of *Domino*, 10 per cent, was comparatively smaller than its leading competitor, *Pizza Hut Co.*,

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<sup>92</sup> For further discussion based on economic rationale, see Howard Marvel, *Supra.*, note 81, pp. 6-11.

<sup>93</sup> ABA, *Supra.*, note 47, p. 168.

<sup>94</sup> E.g., *Morning Glory Co.*, KFTC Decision 2002-163, 2000Yugo0069, Nov. 15, 2000. See also Christopher Stone, 'Closed Territorial Distribution: An Opening Question in the Sherman Act', *The University of Chicago Law Review*, Vol. 30, No. 2, 1963, pp. 286-311.

<sup>95</sup> *Hyundai Motors*, KFTC Decision 2007-281, 2006Dokgam0746, May 18, 2007.

<sup>96</sup> *DPK International Co., Ltd*, KFTC Decision 2000-163, 2000Yugo0069, Nov. 15, 2000.

at 50 per cent.<sup>97</sup> However, it stated that *Domino* still had had significant market power by means of its brand name and unique delivery service.<sup>98</sup> The KFTC admitted that territorial restriction could enhance inter-brand competition through inhibiting intra-brand competition. Nevertheless, it concluded that consumers would get harmed from this restraint. It reasoned that consumers had no choice but to purchase a product with a higher price and less quality because of this practice. The KFTC's position was consistent with the rationale behind the other vertical restraint cases stated above.

Although it recognised the justification of enhancing inter-brand competition, the KFTC still would not take the risk from trade-off between inter-brand competition and some consumer welfare loss. However, the restraint of *Domino* would not result in consumer welfare loss, since this non-price vertical restraint with its market share could not directly affect consumer welfare. Furthermore, based on the nature of the franchise business of monitoring free-riding,<sup>99</sup> the KFTC should have justified its business strategy of franchise delivery service, which would improve competition. Territorial restriction does not impede competition significantly, unless the supplier has considerable market power. Arbitrage may also diminish the effectiveness of territorial restriction, where consumers have lower search and transport costs.<sup>100</sup> This case, however, deviated from these justifications, unlike in the US. In the *Sylvania* case,<sup>101</sup> the US Supreme Court overruled the per se rule stated in *Schwinn*.<sup>102</sup> *Sylvania* established that the per se rule would be moderated in cases of vertical market division.<sup>103</sup> The US courts state that this vertical restraint may be reasonable if likely to promote inter-brand competition without overly restricting intra-brand competition, despite its some ambiguous statement of how the courts balance these.<sup>104</sup> Compared to this approach, the KFTC's rationale seems to be excessively strict. It does not have a sufficient degree of

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<sup>97</sup> This wrongful approach has not been amended in territorial restriction cases, e.g., *Ildong Corp.*, KFTC Decision 2006-439, 2006Sokyoung2008, Dec. 18, 2006. The firm had only a 15 per cent market share but was blamed for Article 23 violation.

<sup>98</sup> See also Myoungsu Hong, 'Su-Jik-Jeok-Bi-Ga-Kyouk-Jae-Han-Ui-Kyoung-Jaeng-Jae-Han-Sung-Pan-Dan (Decisions on Anti-competitiveness of Vertical Non-price Restraints)' in *Kyoung-Jae-Bub-Pan-Rae-Youn-Ku Vol. II [Case Study of Korean Competition Law Vol. II]*, Bubmunsa, Seoul, 2005, pp. 288-90.

<sup>99</sup> See Frank Mathewson and Ralph Winter, 'The Economics of Franchise Contracts', *Journal of Law and Economics*, Vol. 28, No. 3, 1985, p. 521.

<sup>100</sup> See Massimo Motta, *Competition Policy: Theory and Practice*, Cambridge University Press, Cambridge, 2004, p. 304.

<sup>101</sup> *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 US 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977).

<sup>102</sup> *United States v. Arnold, Schwinn & Co.*, 388 US 365, 87 S.Ct. 1856, 18 L.Ed.2d 1249 (1967).

<sup>103</sup> See Thomas Morgan, *Cases and Materials on Modern Antitrust Law and Its Origins*, 2nd edn, West Group, St. Paul, MINN, USA, 2001, p. 516.

<sup>104</sup> Herbert Hovenkamp, *Supra.*, note 37, pp. 483-4.

balance test. Furthermore, it often fails to measure the effects of efficiency improvement by vertical restraints.

#### 4.4.4. Critical Assessments in Restrictive Condition Cases from Economic Debates

A manufacturer's profits are typically an increasing function of rivals' costs. Thus, a manufacturer is willing to take action that can raise rivals' costs. A standard argument in the vertical restraints literature points to the role of foreclosure through exclusive dealing and territorial restriction as a means of this strategy.<sup>105</sup> The major anti-competitive concern is that these practices might foreclose the market and inhibit competition. Such foreclosure might impede efficiency, entry, existence or expandability, any of which can anti-competitively increase the market power of the foreclosing enterprise. If foreclosure prevents a number of rivals from maintaining economy of scale, it impairs their efficiency. This can, therefore, enhance or maintain their market power.<sup>106</sup> In challenging exclusive dealing competition authorities must normally show exclusion from critical input or distribution channels, such that the competitors are deprived of efficiency and price increases, such as shown in the Korean cases, *KAL* and *Domino*.

In the *KAL* case, the KFTC seemed to adopt foreclosure theory, although *KAL*'s practice may have improved inter-brand competition. Even if *KAL*'s practice had not directly improved efficiency, it could have enhanced inter-brand competition. Furthermore, the KFTC did not consider a major benefit. Exclusive dealing potentially minimises the cost and risk of conducting business in uncertain markets, which in turn increases operating efficiencies, and decreases costs for the consumer. A primary benefit is a reduction in transaction costs. By entering into long-term contracts, both the up- and downstream enterprises can avoid the expense of reaching a new agreement for each individual transaction. Therefore, exclusive dealings may lower transaction costs and facilitate distribution simply by building a positive relationship between the parties to the exclusive arrangement.<sup>107</sup> This practice may also allow

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<sup>105</sup> See Michael Katz, 'Vertical Contractual Relations' in Richard Schmalensee and Robert Willig (eds), *Handbook of Industrial Organization, Vol. I*, Elsevier Science Publisher B.V., Amsterdam, 1989, p. 706.

<sup>106</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 63, p. 455-9. The authors explain that where network effects exist, foreclosure can impair rivals' efficiency by denying rivals' access to the number of buyers.

<sup>107</sup> See Oliver Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations', *Journal of Law and Economics*, Vol. 22, No. 2, 1979, pp. 233-61.

businesses to circumvent potential free-riders.<sup>108</sup> Exclusive dealing can, consequently, improve welfare.<sup>109</sup> This, therefore, has a possible efficiency improvement, which helps explain why they are often used even by enterprises without market power, which are not foreclosing a substantial share of any market.<sup>110</sup> Furthermore, a monopolist would have no incentive to engage in exclusionary conduct, since it is costly, unless they were vulnerable to new entrants.<sup>111</sup> However, the KFTC's strict measure has not changed, and its current decision in *Intel*<sup>112</sup> proved that economic efficiency rationale was not accepted.

The main rationale of territorial restrictions is the free-riding justification. Posner asserts that a manufacturer introducing a new product will try to induce distributors to give a sufficient initial investment. Territorial restriction can ensure the distributors' recoupment of pre-sale service investment of, for example, luxury goods.<sup>113</sup> Without such protection, the distributor is unwilling to carry the untried product.<sup>114</sup> These practices are observed with considerably greater favour in the US today. The Chicago School's argument has led to the view that this business practice should be examined under the rule of reason.<sup>115</sup> Free-riding of distributors can be reduced, because a geographical monopoly permits a distributor to recoup the benefits of its sales efforts. It tends, however, to increase a rival manufacturer's cost of entering the market, as working for foreclosure.<sup>116</sup> On the whole, the assignment of territorial restriction is also neutral from the vantage point of efficiency,<sup>117</sup> and the KFTC and the courts should provide a clear guidance for that.

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<sup>108</sup> See Wanda Roger, 'Beyond Economic Theory: A Model for Analyzing the Antitrust Implications of Exclusive Dealing Arrangements', *Duke Law Journal*, Vol. 45, No. 5, 1996, pp. 1018-20; Benjamin Klein and Andres Lerner, *Supra.*, note 91, pp. 478- 519.

<sup>109</sup> For general discussion, see Howard Marvel, *Supra.*, note 81, pp. 6-11; Don Waldman and Elizabeth Jensen, *Industrial Organization: Theory and Practice*, 3rd edn, Addison Wesley, USA, 2007, p. 566.

<sup>110</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 63, p. 457.

<sup>111</sup> See William Landes and Richard Posner, *The Economic Structure of Intellectual Property Law*, Harvard University Press, Cambridge MA, USA and London, 2003, p. 398.

<sup>112</sup> *Intel Corp., Intel Semiconductor Ltd, and Intel Korea*, KFTC Decision 2008-295, 2007Dokgam1790 and 2008Sijang1126, Nov. 5, 2008. See also *Infra.*, Chapter 5.

<sup>113</sup> This rational can be argued in territorial restriction plans in cosmetics industry, e.g., *Johnsons Korea Corp.*, KFTC Decision 2005-180, 2005Gamaeng1066, Sept. 26, 2005.

<sup>114</sup> See Richard Posner, *Antitrust Law*, 2nd edn., The University of Chicago Press, Chicago, 2001, p. 184.

<sup>115</sup> See Patrick Rey and Joseph Stiglitz, 'The Role of Exclusive Territories in Producers' Competition', *The RAND Journal of Economics*, Vol. 26, No. 3, 1995, pp. 431-2.

<sup>116</sup> See Thomas Krattenmaker and Steven Salop, 'Competition and Cooperation in the Market for Exclusionary Rights', *The American Economic Review*, Vol. 76, No. 2, 1986, p. 109.

<sup>117</sup> See Peter Zweifel and Roger Zäch, 'Vertical Restraints: The Case of Multinationals', *The Antitrust Bulletin*, Vol. 48, No. 1, 2003, pp. 280-81.

The potential both to create efficiency and inhibit competition has proven problematic for the courts interpreting competition law and applying it to exclusive dealing<sup>118</sup> and territorial restrictions. The courts in Korea are no exception. These practices in particular introduce social costs. They sometimes block the entry of firms that may be more efficient than the incumbents.<sup>119</sup> The results of foreclosure and entry barriers are high costs to consumers for the lack of real freedom of consumer choice. Thus, in the absence of provable efficiency justifications, the KFTC and the courts may recognise that these arrangements result in foreclosure and entry barriers that ultimately harm the consumer.<sup>120</sup> However, balancing pro-competitive efficiencies against potential anti-competitive effects should be required in more vertical restraint cases than previously believed.<sup>121</sup> In conclusion, the general modern view in competition law economics is that these arrangements have sufficiently mixed effects that they should be neither per se illegal nor per se legal. Instead, they should be judged under the rule of reason that weighs the likely or actual anti-competitive effects against any efficiency or pro-competitiveness justifications.<sup>122</sup> The KFTC and the courts should consider this to improve their economics-based rule of reason.

#### 4.5. Resale Price Maintenance

##### 4.5.1. Critical Assessment of Current Application of Article 29 MRFTA: *Dairy Cases*

Article 29 MRFTA prohibits minimum Resale Price Maintenance (RPM) as per se illegal with some limited exemption conditions.<sup>123</sup> To establish RPM violation, the practice should satisfy two conditions: (i) setting a vertical price; and (ii) coercing the RPM plan. The RPM Guidelines<sup>124</sup> section 3 provides the procedure of the RPM scrutiny of maximum and minimum RPM. Maximum or recommended RPM can be normally justified where efficiency

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<sup>118</sup> Wanda Roger, *Supra.*, note 108, p. 1009.

<sup>119</sup> See Philippe Aghion and Patrick Bolton, 'Contracts as a Barrier to Entry', *American Economic Review*, Vol. 77, No. 3, 1987, p. 389; Eric Rasmusen, Mark Ramseyer, and John Wiley, Jr., 'Naked Exclusion', *The American Economic Review*, Vol. 81, No. 5, 1991, p. 1144.

<sup>120</sup> Wanda Roger, *Supra.*, note 108, p. 1022.

<sup>121</sup> Benjamin Klein and Andres Lerner, *Supra.*, note 91, pp. 479-80.

<sup>122</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 63, p. 459.

<sup>123</sup> Arts. 43 (publications) and 44 (procedures for designating products) of the Enforcement Decree

<sup>124</sup> Resale Price Maintenance Guidelines, KFTC Notification No. 34, legislated Aug. 2006.



or consumer welfare improvements outweigh the harm of anti-competitive effects.<sup>125</sup> For example, if a non-dominant firm practises RPM arrangements in order to prevent high price setting by distributors, the practice can be regarded as legal. If a supplier makes an RPM agreement to prevent distributor cartels, the KFTC will also justify the practice. However, these illustrations do not give sufficient guidance to economic entities, and there have been no justified cases based on the rationale under the Guidelines. In particular, some argue that the KFTC has not established sufficient yardsticks to measure the objective justification or the rule of reason on maximum RPM.<sup>126</sup> There are two major reasons for this criticism. First, the KFTC and the courts have not established clear criteria for Article 19 enforcement, which could be also applicable to vertical agreement. Second, they have treated RPM traditionally as illegal per se and disregarded efficiency justification.

An RPM arrangement can be made through either an agreement or unilateral conduct. However, where there is price-fixing in distribution, Article 29 rather than Article 19 applies, despite its focus on agreement or acquiescence, rather than the unilateral. This is because Article 19 applies only to horizontal cases. Hence, the first condition for RPM violation should be met where there is any conduct regarding vertical price-fixing regardless of by agreement or unilateral. For that reason, coerciveness is an important factor to constitute illegality.<sup>127</sup> Most RPM cases seem to be easily blamed as coercive, especially where regarded as a lock-in case, such as spare part distribution shown in *Renault-Samsung Motors*.<sup>128</sup> This lock-in strategy for establishment of pricing practice or refusal to deal<sup>129</sup> is also commonly blamed in Japan in *Mitsubishi Building Techno*<sup>130</sup> and *Toshiba Elevator*.<sup>131</sup> The KFTC and the JFTC maintain that firms should supply goods at a reasonable price with non-discriminatory measures, as shown in these cases.

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<sup>125</sup> Sec. 3.B.(2) of the RPM Guidelines.

<sup>126</sup> Jungwon Song, *Supra.*, note 8, p. 479.

<sup>127</sup> Ho Young Lee, *Supra.*, note 12, pp. 395-6.

<sup>128</sup> *Renault-Samsung Motors*, KFTC Decision 2004-017, 2003Choi3739, Jan. 19, 2004. The enterprise had RPM contracts with its spare part retailers.

<sup>129</sup> E.g., *Panasonic*, JFTC Decision, July 27, 2001, *Shinketushu* 48-187. In this decision, the JFTC decided that *Matsushita* infringed the AML for its refusal to deal with non-contract retailers. See also Masako Wakui, *Supra.*, note 57, p. 115.

<sup>130</sup> *Mitsubishi Building Techno*, JFTC Decision, July 26, 2002, *Shinketushu* 49-168. *Mitsubishi* supplied spare parts of elevators at a higher price to independent service providers, which infringed the UBP provision.

<sup>131</sup> *Toshiba Elevator Corp.*, Osaka High Court, July 30, 1993, *Shinketushu* 40-651. *Toshiba* refused to supply spare parts to independent service providers. See also Masako Wakui, *Supra.*, note 57, pp. 185-8.

Therefore, although an RPM is recommended, if the firm controls retail price through regular checks and other vertical practices, such as refusal to deal, it is considered minimum PRM. For example, the Supreme Court in *Namyang Dairy Products Co, Ltd*<sup>132</sup> held that a recommended RPM could not be an infringement of Article 29 as long as it did not force a distributor to accept the supplier's price-fixing. Although one of the *Namyang's* agents researched its product prices in the market after notice of a recommended price, it appeared difficult to believe that its check-up showed an intention to force its retailers to maintain the recommended price. Its agent proposed a recommended price, and notified that it would refuse to supply where the retailer did not comply with the suggested price. However, *Namyang's* agent did not have the power to not supply, and *Namyang* would not stop supplying the goods to large retailers, although retailers lowered the price. Moreover, the retailers already knew the practice of *Namyang's* agent could not be effective, and there had been no history of stopping supply. Therefore, the retailers did not pay attention to the pricing recommendation since it was not made by *Namyang*. Thus, the Court rejected the KFTC's argument. It agreed that simply an independent decision of an agent to adhere to the price did not infringe Article 29.

In the *Maeil Dairy Industry Ltd* case,<sup>133</sup> however, a different judgment emerged. The Supreme Court upheld the Seoul High Court's judgement that *Maeil* infringed Article 29, based on effect and its intention of prohibiting competition. *Maeil* notified recommended RPM to retailers, whilst threatening that it would discontinue supply where the retail price was inconsistent with the proposed one. *Maeil's* managers also informed price maintenance to headquarter and distribution agents, to control and guide its price plan. The Court upheld the KFTC's decision on the grounds that there was an actual anti-competitive effect observed from the price maintenance, and this meant in reality a minimum RPM. There are several issues in these cases.<sup>134</sup> *Namyang* did not actually force its retailers to accept its recommended price, and its retailers freely chose the prices.<sup>135</sup> On appeal, therefore, the

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<sup>132</sup> *Namyang Dairy Products Co. v. KFTC*, Seoul High Court, 99Nu13, Oct. 7, 1999; Supreme Court 99Du11141, Dec. 24, 2001.

<sup>133</sup> *Maeil Dairy Industry Ltd v. KFTC*, Seoul High Court 98Nu14947, Jan. 28, 2000; Supreme Court 2000Du1829, May 31, 2002.

<sup>134</sup> This judgment is a little similar to that of the US case, *United States v Parke, Davis & Co.*, 362 U.S. 29 (1960) at 44. The US Supreme Court also held that where a firm's actions go beyond mere announcement and the simple refusal to deal and it employs other means which effect adherence to RPM, it violates law.

<sup>135</sup> This judgment was similar to the Japanese case, *Fuijiki v. Shiseido*, Tokyo High Court, Sept. 5, 1993, *Hanrei Jiho*, 1474. The Tokyo High Court held that there was no evidence to show that the requirements imposed by

Court rejected the KFTC's narrow interpretation of RPM. It held that the *Namyang's* agent could not terminate or threaten to terminate contracts with non-complying dealers, although threat of termination might have induced retailers to adhere to the recommended RPM. It did not specifically state whether an agreement could have been based on the facts, leaving some ambiguity about whether it viewed *Namyang* as going beyond the mere evidentiary requirement to find an agreement, and granting a substantive right to the supplier to engage in certain forms of vertical restraints. In *Maeil*, however, the Court reasoned that the enterprise in fact restrained the freedom of its retailers from setting the price, by coercive means. Moreover, *Maeil* made its retailers assume that it would discontinue supplying products if the retailers would not accept the price plan. Nevertheless, this distinction is vague. Since Article 29 applies to RPM cases whether they are concerted or unilateral, it is a huge burden for the KFTC and the courts to prove the RPM is minimum or recommended, and even whether it is coercive.

The findings in the Korean cases are therefore very different from the US judgments in *Colgate*<sup>136</sup> and *Monsanto*.<sup>137</sup> The US Supreme Court has held that a manufacturer does not engage in a concerted action with the meaning of RPM of the Sherman Act section 1, when it announced a pricing policy unilaterally, and refused to do business with distributors that failed to adhere to the policy. In general, a supplier does not infringe RPM provision if it engages only in exposition, persuasion and argument to encourage dealers to charge the recommended prices. This distinction is crucial.<sup>138</sup> Thus, there is a significant difference between *Colgate* and *Namyang*. The US case focused on whether the practice was unilateral or concerted. However, coerciveness was centred in the Korean judgements. This difference is caused from the problem of misapplication of Article 19 MRFTA, for its application only to horizontal agreements. As long as it is unclear whether Article 19 can be applicable to vertical agreements, the examination based on coerciveness causes difficulties for the courts

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*Shiseido* were intended to maintain the retail price. For further detail, see Mitsuo Matsushita, 'The Antimonopoly Law in Japan' in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington D.C., 1997, pp. 168-9.

<sup>136</sup> *United States v. Colgate & Co.*, 250 US 300 (1919). The US Supreme Court first stated the agreement requirement for RPM in this case. For further detail about *Colgate* doctrine, See also Keith Hylton, *Supra.*, note 60, pp. 270-72; Herbert Hovenkamp, *Supra.*, note 37, pp. 465-6.

<sup>137</sup> *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 US 752 (1984). In this case, 2 basic distinctions were discussed: (i) between concerted and independent action; and (ii) between price and non-price restraints.

<sup>138</sup> E.g., *United States v. Parke, Davis & Co.*, 362 US 29, 44 (1960). See also Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Supra.*, note 30, pp. 570-73; ABA, *Antitrust Law Developments*, Vol. I, 6th edn, ABA Publishing, Chicago, 2007, pp. 138-9.

and lawyers. The line between what is permissible encouragement to adhere to a supplier's suggestion, and aggressive and impermissible vertical price-fixing, is difficult to draw. Any attempt to persuade dealers to go along with recommended prices under the MRFTA should be carefully reviewed.<sup>139</sup> If this rationale is understood, the only problem is why Article 19, as a provision of concerted agreements, cannot be applicable to RPM cases, and what Article 29 is necessary for.

#### 4.5.2. Critical Assessments in RPM Cases from Economic Debates

There is a major debate regarding the adoption of RPM. It can ensure the provision of high-quality pre-sale service from retailers in order to prevent free-riders. Telser proposes a model of RPM that frequently has been considered benign, because retailers are the least-cost means of delivering valuable information to potential buyers.<sup>140</sup> Despite some positive outcomes from RPM, there are still anti-competitive fears that the KFTC bears as following. RPM may be the result of collusion amongst small retailers to keep prices high. The most important reason for RPM is the wish of small retailers to compete with large discount stores. However, RPM might make tacit collusion amongst manufacturers easier to maintain. It is used to set prices to reflect the collusive price, either to make it easier to detect cheating, or to reduce incentives to cheat. This theory is one of the primary anti-competitive theories used to justify per se prohibition.<sup>141</sup> Moreover, some argue that there are insufficient empirical data showing that RPM is effective in preventing free-riding, and RPM cannot solve the free-riding problem.<sup>142</sup> For example, prevention of free-riding can be avoided through other vertical restraints, such as tying vertically price-fixed products with other separate items. Distributors may sell these tied products with discounts, and this conduct may result in the effect of free-riding.<sup>143</sup> Therefore, RPM can be considered as the means of restricting competition to obtain and retain monopoly power, rather than preventing free-riding where the supplier has a

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<sup>139</sup> This is also the issue in the US regime. See Douglas Broder, *A Guide to US Antitrust Law*, Sweet & Maxwell, London, 2005, p. 64.

<sup>140</sup> See Lester Telser, 'Why Should Manufacturers Want Fair Trade?', *Journal of Law and Economics*, Vol. 3, 1960, pp. 86-90; Luis Cabral, *Introduction to Industrial Organization*, The MIT Press, Cambridge MA, USA, 2000, p. 195; Don Waldman and Elizabeth Jensen, *Supra.*, note 109, pp. 566-7.

<sup>141</sup> See Pauline Ippolito, 'Resale Price Maintenance: Empirical Evidence from Litigation', *Journal of Law and Economics*, Vol. 34, 1991, pp. 281-2.

<sup>142</sup> See Stanley Ornstein and Dominique Hanssens, 'Resale Price Maintenance: Output Increasing or Restricting? The Case of Distilled Spirits in the United States', *The Journal of Industrial Economics*, Vol. 36, No. 1, 1987, p. 2.

<sup>143</sup> See Howard Marvel, 'The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom', *Antitrust Law Journal*, Vol. 63, 1994, pp. 63-5.

dominant position.<sup>144</sup> This has been brought to the KFTC's attention, which seems to regard RPM as efficiency-detracting rather than enhancing.

In some cases, the KFTC could have been more lenient, based on the efficiency justification. The suppliers of luxury products, *KGC Corp.* and *Chongkeundang Corp.*,<sup>145</sup> struggled to keep their brand images through product certification<sup>146</sup> by sustaining a certain level of price set. They tried to stop sales of their products as loss leaders by retailers. However, the KFTC decided their RPM arrangements were as a violation per se without further consideration. These RPM, whether maximum or minimum, could improve efficiency by eliminating free-riding and improving inter-brand competition, since the enterprises did not have market power. Furthermore, their RPM practices could guarantee quality of the products, since consumers prefer products sold by a reliable distributor, which might improve consumer welfare. According to the RPM Guidelines, the KFTC considers efficiency outcomes, but in practice these are hardly examined. This lack of economic rationale has caused ambiguous implementation of the per se rule and the rule of reason.

Much economic analysis of vertical restraints is ambiguous, and such ambiguity and the complexity of cases suggests that a rule of reason rather than a per se approach to competition policy will produce more efficient results.<sup>147</sup> This is distinct in the US, and the KFTC can learn from the American experience. The *Dr. Miles*<sup>148</sup> prohibition of RPM affected the development of US antitrust law. *Dr. Miles* had involved contracts which undertook to prevent dealers from freely exercising the right to sell. The US Supreme Court concluded there was an impact on competition, largely because it believed that RPM was the product of a conspiracy of retail dealers, rather than representing a policy that served the interest of *Dr. Miles* itself.<sup>149</sup> However, eight years later, the Court noted an important qualification in *Colgate*.

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<sup>144</sup> Peter Zweifel and Roger Zäch, *Supra.*, note 117, pp. 281-3.

<sup>145</sup> E.g. *KGC Corp.*, KFTC Decision 2005-182, 2005*Teukbo*0320, Sept. 26, 2005; *Chongkeundang Corp.*, KFTC Decision 2005-183, 2005*Teukbo*0533, Sept. 26, 2005. The relevant products were supplementary health foods.

<sup>146</sup> For further discussion about quality issue, see Warren S. Grimes, 'Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited', *California Law Review*, Vol. 80, No. 4, 1992, pp. 844-6.

<sup>147</sup> See Michael Utton, *Market Dominance and Antitrust Policy*, Edward Elgar, Hants, UK and Brookfield, USA, 1995, pp. 272-3.

<sup>148</sup> *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 US 373, 31 S.Ct. 376, 55 L.Ed. 502 (1911).

<sup>149</sup> Thomas Morgan, *Supra.*, note 103, p. 316; Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution*, Harvard University Press, Cambridge MA, USA and London, 2005, pp. 186-9.

It held that the firm had only done what any firm might do, and also stated that in the absence of any purpose to create or maintain a monopoly, the antitrust law does not restrict the recognised right of the manufacturer engaged in an entirely private business. He is free to exercise his own discretion as to traders with whom he will deal. Of course, a firm may announce in advance the circumstances under which they will refuse to sell.<sup>150</sup> This so-called *Colgate rule* continued to be extremely important.<sup>151</sup> In *Albrecht*,<sup>152</sup> the Court held that maximum RPM was a per se violation of section 1 of the Sherman Act, but overruled in *State Oil*.<sup>153</sup> In this case, the Court stated that there was insufficient economic justification for per se invalidation of maximum RPM. Almost 75 years after *Dr. Miles*, the court could not resolve the controversy over the public interest impact of vertical restraints before the *Leegin* case.<sup>154</sup> The Court's view in *Dr. Miles* was challenged by the Chicago scholars, arguing that vertical restraints may stimulate inter-brand competition by inhibiting intra-brand competition, which may benefit consumers in the end.<sup>155</sup> This was the central to the Court's decision in the *Sylvania* case, and later, the *Leegin* case.

#### 4.6. Trade-Off and Balance Tests in the Korean Case Law

##### 4.6.1. Fairness and Pro-competitiveness: Market Foreclosure vs. Efficiency

The issue of interpretation of fairness and pro-competitiveness has been one of the most controversial problems in Korea. The definition of fairness is, in fact, very obscure in market function. If the KFTC and the courts take a more market-friendly approach in their implementation of law, they should define the meaning of fairness as pro-competitiveness. Fairness in vertical cases should be, thus, understood as maximisation of balancing inter- and intra-brand competitiveness, and also of the trade-off between anti-competitiveness and efficiency. However, this approach has been hardly recognised in practice. There is a leading case showing how the KFTC's trade-off test often fails. *SK Inc.*, an oil refinery company,

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<sup>150</sup> *United States v. Colgate & Co.*, 250 US 39 S.Ct. 465, 63 L.Ed. 992 (1919).

<sup>151</sup> Thomas Morgan, *Supra.*, note 103, pp. 112-3.

<sup>152</sup> *Albrecht v. Herald Co.*, 390 US 145 (1968).

<sup>153</sup> *State Oil Co. v. Khan*, 522 US 3, 118 S.Ct. 275, 139 L.Ed.2d 199 (1997).

<sup>154</sup> *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 US (2007).

<sup>155</sup> Thomas Morgan, *Supra.*, note 103, p. 604.

vertically merged an oil pipeline conveyor firm, *Dopco*.<sup>156</sup> In this case, the KFTC investigated whether *SK* intended to strengthen its market power through vertical foreclosure. *SK* had a market share of 30.1 per cent and its major competitors, *LG Co.*, *S-Oil Co.*, and *Hyundai Co./ Incheon Refinery Co.* had 24.6, 10.9, and 15.6 per cent respectively. The KFTC concluded that the refinery and distribution markets were oligopolistic, based on the fact that the relevant total market share of the top three enterprises was 83.3 per cent, which was sufficient to be blamed as market dominant under Article 4 MRFTA.

Concerned about the possibility of anti-competitiveness and market foreclosure through the stated essential facility, the KFTC held that the vertically merging firm would refuse to deal with its competitors and potential entrants. In addition, the firm would possibly discriminate against competitors, which could be considered unfair through delay of trade. The KFTC argued that there was a high cost of establishing an oil refinery business,<sup>157</sup> which could possibly be an entry barrier. The KFTC implicitly indicated that it outweighed the harm from the ‘market containment effects’ over efficiency, especially where penetration of foreign firms into Korea was not expected.<sup>158</sup> This rationale is somewhat similar to the Japanese vertical merger oil transport case<sup>159</sup> in which the JFTC concluded the vertically merging firm might gain exclusive dealing in the downstream level, resulting in a substantial restraint of competition.<sup>160</sup> However, this rationale was wrong, because there would be an alternative method of distribution in oil transport. Furthermore, these authorities disregarded efficiency outcomes from reduction of transaction costs from the vertical relations.

As shown in this case, the KFTC is not very concerned about the efficiency enhancement from vertical cases. *SK*’s market share was approximately 30 per cent, which is hardly considered as market dominant firm in other regimes. Under wrongful application of the Concentration Ratio (CR) test, this firm was regarded as market dominant. The KFTC

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<sup>156</sup> *SK Inc./Deahan Refinery Corp.*, KFTC Decision 2001-090, 2001Kikyoul/1398, June 29, 2001. This merger was assumed as raising the cost of entry by control of pipelines. The KFTC imposed structural remedies. For further comparative discussion regarding entry barrier in the US oil industry and divestiture case, see Walter Adams, ‘Vertical Divestiture of the Petroleum Majors: An Affirmative Case’, *Vanderbilt Law Review*, Vol. 30, No. 6, 1977, pp. 1115-47.

<sup>157</sup> This capital cost could be argued as entry barrier. See Preston McAfee, Hugo Mialon, and Michael Williams, ‘What is a Barrier to Entry?’, *The American Economic Review*, Vol. 94, No. 2, 2004, pp. 464-5.

<sup>158</sup> For further discussion, see also Korea Fair Trade Association, *Gong-Jung-Go-Rae-Sim-Kyoul-Sa-Rae-Kuk-Jae-Bi-Kyo [Cases of Comparative Competition Laws]*, Parkyoungsa, Seoul, 2003, p. 111.

<sup>159</sup> *Nihon Sekiyu Unsou*, JFTC Decision, June 25, 1951, *Shinketushu* 3-73.

<sup>160</sup> For further detail, see Masako Wakui, *Supra.*, note 57, p. 223.

could have scrutinised the real impact from vertical control. The enterprise could improve efficiency through reducing transaction costs. The KFTC could not foresee the pro-competitive and efficiency results because of its narrow definition of fairness and unjust *ex ante*. Firm size does matter in Korea. In particular, the *POSCO* case<sup>161</sup> evidenced that the KFTC heavily relied on the fact that the firm had been appointed as a dominant firm, disregarding other factors. *POSCO* could lose the chance of strategic management of cost savings and the incentives of potential investment on R&D. The firm's know-how of hot coil production was the outcome of its twenty-year R&D efforts.<sup>162</sup>

The KFTC, however, wrongfully decided that the argument in the case was merely about distribution rather than the productive and dynamic efficiency by intellectual property protection.<sup>163</sup> In fact, *Hysco*, an affiliate of the *Hyundai* group, was also a potential competitor, and could foreclose *POSCO*'s distribution through vertical integration, since it was supplying automobile parts to *Hyundai Motors* and *Kia Motors*, *POSCO*'s largest customers. The *Hyundai* group could abuse its dominant position by its monopsony power. It could leverage its vertical power over the horizontal. However, the KFTC did not closely examine this problem. Furthermore, although the Supreme Court reversed the KFTC decision, which shows the judgment was right, it did not give the answer to this issue. The *POSCO* and *SK* cases explain how much the KFTC and the courts have established a measure, which is a high priority, of examining the size of firm and size of the relevant market. They focus more on unfairness of discrimination rather than pro-competitiveness. In the *POSCO* case, in particular, the KFTC did not examine the argument that *Hysco* could free-ride on a cheap supply from *POSCO*. *POSCO* could have supplied the product to its rival, bearing the cost of future risk of foreclosure. The courts still need to examine these issues in vertical restraints based on economics.

The KFTC has also shown lack of legal technique regarding economic justification. In *Charmzone Cosmetics Co.*,<sup>164</sup> the KFTC prohibited territorial restriction in the franchising agreement, although *Charmzone* did not have a sufficient degree of market power. The

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<sup>161</sup> *POSCO*, KFTC Decision 2001-068, 2001Kyoungchok0389, Apr. 12, 2001.

<sup>162</sup> For further discussion of *ex ante* incentives for investment and efficiency in monopolisation, see Einer Elhauge, 'Defining Better Monopolization Standards', *Stanford Law Review*, Vol. 56, No. 2, 2003, p. 256.

<sup>163</sup> Intellectual property such as copyright, patent, trademark is exempted from the MRFTA enforcement under Art. 59 MRFTA.

<sup>164</sup> *Charmzone Cosmetics Co.*, KFTC Decision 95-292, 9508Kyoungjung743, Dec. 5, 1995.



enterprise had only 1.6 per cent market share, but the KFTC concluded that *Charmzone* violated Article 23, since the enterprise's practice was simply anti-competitive and did not improve inter-brand competition.<sup>165</sup> The KFTC did not allow the efficiency justification, although *Charmzone* tried to ensure pre-sale services against free-riders. Its practice could be essential to promote quality protection, since it was a justifiable practice for a producer of luxury goods such as cosmetics to protect its brand name. *Charmzone's* territorial restriction could, thus, prevent free-riding and improve inter-brand competition. Furthermore, the KFTC sometimes does not scrutinise market structure. In the *DPK International* case,<sup>166</sup> the market leader was *Pizza Hut*, and *Domino* was trying to improve its franchise service through territorial restriction by its '30 Minutes Delivery' practice.<sup>167</sup> The KFTC should have considered this territorial restriction as a promotional method for entering the market, because *Domino's* practice could bring more pro-competitive effects between competitors.

Compared to other relevant cases,<sup>168</sup> the defendants in these two cases did not have significant market power to distort competition. Thus, consumers could have alternative choices of products than from the defendants, and there was no high degree of consumer welfare loss from this practice.<sup>169</sup> The practices in these cases could, moreover, improve not only inter-brand competition, but also consumer welfare, since consumers could rely on product quality. If the enterprises in these cases had not restricted territories for product quality protection, consumers could have not relied on their brand names. The KFTC, however, never explains why this type of restraint is obviously damaging to competition. Although these restraints could diminish intra-brand competition, they might increase inter-brand competition to the extent that such restraints enhanced the attractiveness of the supplier's products.

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<sup>165</sup> For further discussion, see also Sung-Hoon Yoon, 'Franchise-Wa-Kyoung-Jaeng-Jae-Han (Restraints on Competition and Franchise)' in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsu, Seoul, 2002, p. 501.

<sup>166</sup> *DPK International Co., Ltd*, KFTC Decision 2000-163, 2000Yugo0069, Nov. 15, 2000.

<sup>167</sup> The present Fair Franchise Transactions Act [amended by the law No. 8630, Aug. 3, 2007] covers franchise cases. Under Art. 12(1) of Franchise Act, refusal to deal, territorial restrictions and etc. are prohibited. This Act foremost applies under Art. 38 Franchise Act where both of Art. 23 MRFTA and Art. 12 Franchise Act are applicable.

<sup>168</sup> E.g., *Dongwon Co.*, KFTC Decision 92-81, 9203Dok082, July 1, 1992; *Pusan Dairy Association*, KFTC Decision 93-61, 9301I262, June 30, 1993. In these cases, the enterprises had more than 40 per cent of market share.

<sup>169</sup> Korea Fair Trade Association, *Supra.*, note 158, pp. 206-7.

#### 4.6.2. Critical Argument of Case Law Development in Rule of Reason and Per Se Rule

One of the competition courts' functions is to formulate competition rules with active economic competitive goals.<sup>170</sup> In particular, the US judges may come to the courts with ideologies, as well as formal training in economics, all of which lead them to be receptive to some economic ideas and unreceptive to others, because US courts have internal sources of economic ideas that may influence their antitrust judgments.<sup>171</sup> The US does not solely benefit from economics. In particular, EC competition policy change towards an increasing understanding of economics in competition issues is a kind of revolution. Their economics-based approach towards vertical agreement is an example. This policy change has its basis in case law.<sup>172</sup> Therefore, the ideal rules should be both clearly predictable in their application, and economically rational. However, it seems that Korean courts have not developed case law as such, because it is often difficult for them to formulate rules that are both clear and economically rational. In the *POSCO* case, the Seoul High Court showed an immature judgment. The High Court did not take an *ex ante* approach. *POSCO* could have taken the risk of future uncertain demand. The vertically affiliated structure of *Hyundai* group could also strengthen its market power in up- and downstream levels. Nevertheless, the High Court did not closely examine this problem, and simply concluded the vertical structure problem was not related to abusive conduct in the case. The High Court did not take an *ex ante* and rule of reason approach.

The courts have also misunderstood the rule of reason approach in some cases. *Lotteria Co., Ltd.*,<sup>173</sup> a fast food franchise giant in Korea, was justified in its tie-in sale by the rule of reason, and held no violation of Article 23. In this case, the enterprise tied cooking facilities and product ingredients. *Lotteria* had significant market power and was one of the large business groups. However, the Seoul High Court only considered the unique system of franchise and its product quality justification, by agreeing to *Lotteria's* argument of

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<sup>170</sup> See Donald Turner, 'The Virtues and Problems of Antitrust Law' in Theodore Kovaleff (ed), *The Antitrust Impulse: An Economic, Historical, and Legal Analysis Vol. II.*, M.E. Sharpe, New York, 1994, p. 956.

<sup>171</sup> See Andrew Gavil, 'Competition Policy, Economics, and Economists: Are We Expecting Too Much?' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Competition Law 2006*, Juris Publishing, Huntington NY, USA, 2006, p. 581.

<sup>172</sup> See Doris Hildebrand, *The Role of Economic Analysis in the EC Competition Rules*, 2nd edn, Kluwer Law International, The Hague, 2002, pp. 415-6.

<sup>173</sup> *Lotteria Co. Ltd v. KFTC*, Seoul High Court, 2000Nu2183, Dec. 4, 2001; Supreme Court 2002Du332, Mar. 10, 2006. The Supreme Court affirmed the most of the Seoul High Court judgment.

efficiency and quality assurance.<sup>174</sup> The High Court held there was no evidence that *Lotteria* took any advantages or benefits from its tying practice. It stated *Lotteria* simply supplied additional ingredients with a lower price.<sup>175</sup> However, its rationale was wrong. *Lotteria* abused its dominant position to make a tying arrangement. Its franchisees could have purchased cooking facilities and ingredients such as vegetables from other suppliers for a cheaper price, unless *Lotteria* had imposed a tying arrangement. Furthermore, its tying practice did not improve efficiency or guarantee quality of goods, since these tied facilities and ingredients were not really related to product quality improvement. If the High Court had recognised negative effects from the franchisor's market power, it would not have allowed the tying practice of *Lotteria*. The essential aspect of a franchise distribution arrangement is the creation of a standardised product, which consumers can expect to receive at various retail locations.<sup>176</sup> Because of free-riding and purposes of ensuring the goods quality, tying practice is essential. However, the practice of *Lotteria* was not certain to be justified by this rationale.<sup>177</sup>

Both the *POSCO* and *Lotteria* cases illustrate that the courts applied economic justification wrongfully, and they need to examine vertical restraint under the clear economics principle, for rule of reason development. Vertical arrangements are likely to serve the socially useful purpose of economising on quality-policing costs. However, because these practices may also increase anti-competitive problems, the courts should develop balance tests based on economic theories. The case law concerning abusive practices have not sufficiently delineated the permissible boundary of firms' activities. In light of legal certainty and predictability of market participants, they should develop more specific, consistent and legally sound criteria for distinguishing anti-competitive practices from competitive ones.<sup>178</sup> For Korean competition law development, the courts have not given a detailed guidance to the rule of reason analysis of vertical restraints. It is difficult for them to weigh one type of competition against the other, because there is no yardstick for assigning relative values to each. One can theorise at least two balancing mechanisms that the courts can attempt. They

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<sup>174</sup> This case can be compared with the US case, *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971). The quality defence was not granted in the US case.

<sup>175</sup> For further discussion, see also Sung-Hoon Yoon, *Supra.*, note 165, p. 510.

<sup>176</sup> Benjamin Klein and Lester Saft, *Supra.*, note 37, p. 349.

<sup>177</sup> In this case, the Supreme Court, however, held the tying practice of cash machines, electronic supplies and detergents were not justifiable for brand image improvement.

<sup>178</sup> Bong Eui Lee, *Supra.*, note 25, pp. 80-81.

may weigh reduced intra-brand competition against increased inter-brand competition. Another standard focuses on the question whether a restraint promotes an increase in inter-brand competition. The underlying notion is that where inter-brand competition is enhanced, consumers ultimately benefit from the increase in rivalry.<sup>179</sup> Then, the market power approach is the essential one.

The possession of market power by a firm does not necessarily or even commonly suggest that its vertical arrangement is anti-competitive. However, the market power screen has the advantage of enabling courts to quickly assess cases where the defendant cannot adversely affect competition.<sup>180</sup> Normally, if the leading enterprise has over 50 per cent market share, there is no close rival.<sup>181</sup> Therefore, the Korean courts need to consider the market share a crucial yardstick to justify vertical restraints to develop the rule of reason, whilst considering the special responsibility of large firms. In order to fully develop the rule of reason approach, the courts should further build up criteria to justify vertical restraints. The judgements of the courts have been criticised, since the case law has not guided lawyers and enterprises properly, resulting in confusion between distortion of competition and efficiency. The courts, moreover, have not clearly demonstrated their understanding of the theoretical background of competition law, generally related to economic theories of vertical restraints, when they implement the law under per se rule or rule of reason. Since the markets which form the setting for vertical restraints are often very complex, the traditional modes of analysis in Korea are inappropriate. The choice between the per se rule and the rule of reason analysis makes an enormous difference to the way a case proceeds, and to its likely outcome, as seen in the US.<sup>182</sup> Therefore, the courts need to adopt and develop the rule of reason standard, and give up the per se rule in vertical cases, as long as they find a necessity of flexible judgements to achieve the gains of efficiency. This is because disastrous judgments, without successful development of the rule of reason, will have painful consequences in the market.

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<sup>179</sup> See Kevin Arquit, 'Market Power in Vertical Cases', *Antitrust Law Journal*, Vol. 60, 1992, p. 922.

<sup>180</sup> *Ibid.*, pp. 923-4.

<sup>181</sup> See William Shepherd, *The Economics of Industrial Organization*, 3rd edn, Prentice Hall, Englewood Cliffs, NJ, USA, 1990, pp. 17-8; William Shepherd, 'Section 2 and the Problem of Market Dominance' in Theodore Kovaleff (ed), *The Antitrust Impulse: An Economic, Historical, and Legal Analysis Vol. II.*, M.E. Sharpe, New York, 1994, p. 1009.

<sup>182</sup> See Marc Fajer, 'Taming the Wayward Children of Monsanto and Sylvania: Some Thoughts on Developmental Disorders in Vertical Restraints Doctrine', *Temple Law Review*, Vol. 68, 1995, p. 101.

#### 4.7. Concluding Remarks

The Korean market is opening outwards, and the importance of reforming competition law on vertical restraints increases. Since competition law is the crucial measure to ensure sound market mechanism and trade, the KFTC should develop its techniques of implementation and enforcement through reforming vertical regulation. Moreover, as stressed, vertical restraint is deeply related to economic efficiency, international trade, and economic growth. Therefore, not only strengthening *Chaebols'* market foreclosure by tolerance in vertical regulation, but also lessening efficiency by an unnecessary restriction of pro-competitive practice is undesirable. The KFTC has already provided sufficient competition implementation to solve economic concentration, by preventing anti-competitive abusive conduct by *Chaebols*, such as controlling establishment of holding companies, cross-shareholding, debt guarantee, and ceiling shareholding.

The current legal provision is disadvantageous to domestic enterprises where the KFTC wrongfully investigates their practices. It should thus reform implementation of the competition law, at least of vertical restraints. The KFTC needs to develop the rest of the legal provisions to improve competition through reforming vertical regulations such as Articles 3-2, 19, 23, and 29 MRFTA. This regulatory reform plan is beneficial to the national economy through sound competition. This will maximise efficiency from competitiveness. The next chapter will examine and assess the existing statute; whether it satisfies the aims of competition law, and improves competition by means of efficiency justification. It is crucial for the KFTC to establish a more accurate model of vertical regulation that may decrease errors in the courts, and reduce the costs of litigation. Furthermore, this will give guidance for the courts to develop the rule of reason. Its newly developed guidelines can also make for a simpler and easier application of law. Before suggesting this new rule in Chapter 6, the next chapter will examine problems in the MRFTA and the guidelines.

## Chapter 5

# Critical Analysis of Competition Law on Vertical Restraints

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### 5.1. Demands for Vertical Regulation Reform

When a country relies heavily on efficient and effective international competition in order to achieve the goal of economic growth, a sound approach to vertical regulation should play an important role.<sup>1</sup> This is because vertical arrangements are the gateway of international trade, and competition in the global market. The Korea Fair Trade Commission (KFTC) should act in the pursuit of achieving efficient outcomes, with reference to appropriate economic principles. However, it has not properly established a sound structure of legal provisions on vertical restraints (hereafter, vertical regulation), as criticised in the case studies. The KFTC has demonstrated some effort in regulatory reform, through adopting guidelines with regard to vertical restraints. Nevertheless, its legal provisions do not give clear guidance to competition lawyers and enterprises regarding efficiency-improvement, which may improve domestic market competition. Without proper assessment of vertical restraints, Korean competition law on vertical restraints may create a discriminatory environment against domestic firms, and also prevent beneficial outcomes by vertical restraints.

Efficiency is closely dependent on the operation of markets, because ideally it is a distributive or relational concept, which embraces the whole economy.<sup>2</sup> Thus, the KFTC should seek the best way of efficiency-achievement for the state economy. However, the KFTC, and the courts also, have shown lack of ability in assessing pro- and anti-competitive effects by vertical restraints. Their misleading decisions and judgements from misguided

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<sup>1</sup> *Supra.*, Chapter 2.

<sup>2</sup> See Carl Kaysen and Donald Turner, 'Antitrust Policy: An Economic and Legal Analysis' in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, p. 182.

enquiries have resulted in harm to competition, as well as to the state economy. In particular, the KFTC has been traditionally concerned about market dominance of large business groups. However, it is necessary to examine closely whether it needs to outweigh the efficiency and pro-competitive effects of vertical restraints, anticipating vigorous competition on opening the market to globalised competition. When the market is open to foreign competitors, this excessive concern may distort competition and the market economy. The relaxed application of vertical regulation can increase efficiency benefits. Nonetheless, a far less stringent enforcement also does not achieve this aim. A strategic enforcement favouring domestic firms may foreclose the domestic market against foreign firms, which can distort competition and trade. Therefore, the KFTC should take on the task of legislating regulatory provisions that may balance efficiency outcomes and promote international trade by vertical practices.

The KFTC has applied strict legal measures on vertical restraints where the enterprise has a certain degree of market share, although its market power does not demonstrate significant harm to competition. Vertical practices of enterprises without significant market power, although they may promote competition, have been treated as a category of per se or quasi-per se violation of the law. There are several reasons why the KFTC has difficulties in dealing with vertical restraints. First, economists have not been consistently helpful, with a less than uniform approach to vertical restraints.<sup>3</sup> Second, and most important, Korean competition policy has been trapped in the past by focusing on curbing market concentration. Part of the reason for the present problem is a reaction to this, which reflexively condemned any restraint fitting a predetermined definition of per se illegal abuse of market dominance. The KFTC has taken legal measures to deal with problems unique to the Korean economy, including those posed by *Chaebols*, with their excessive concentrations of wealth and internal transactions subsidising their affiliates.<sup>4</sup> This problem, therefore, became attributable to the fear of according discretion to the KFTC.<sup>5</sup>

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<sup>3</sup> See Patrick McNutt, *Law, Economics, and Antitrust: Towards a New Perspective*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2005, p. 311.

<sup>4</sup> See Sai Ree Yun and Dae Sik Hong, 'Korea: Overview', *Global Competition Law Review*: [http://www.globalcompetitionreview.com/sr/sr\\_fullpage.cfm?page\\_id=622](http://www.globalcompetitionreview.com/sr/sr_fullpage.cfm?page_id=622) (accessed 20 April 2008).

<sup>5</sup> This problem is not only seen in Korea but also other regimes. See John Flynn and James Ponsoldt, 'Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, pp. 287-8.

The KFTC has wrongfully interpreted the law aimed at a balanced economic growth<sup>6</sup> as only meaning the protection of Small and Medium-sized Enterprises (SME), rather than overall economic development of the state, which should have been considered as one of the most important purposes of competition law.<sup>7</sup> The existing competition law has set a double standard, favouring SMEs and foreign competitors, by discriminating against domestic large enterprises. Market concentration may upset the ideology of a perfectly competitive market. However, it is not clear whether it inhibits the efficiency of the competitive process, especially in vertical restraints.<sup>8</sup> It is not necessary to maintain the strict measure of existing competition law and policy on vertical restraints, particularly where they do not impede inter-brand competition and international transaction.

The KFTC seems to have lost its way to enhance competition in the domestic market, and promote economic growth, without an economics-basis. Over the past thirty years, Korean competition law has promoted social welfare and continuous economic development through various pro-competitive measures. As a result, Korea has improved market competition. Although the KFTC's reform effort has established the foundation for a sound market economy, it needs to further reform and adopt measures in order to accomplish continuous economic growth through competition.<sup>9</sup> To achieve the objectives of the competition and solve the problems stated, this chapter examines current legal provisions on vertical restraints. This chapter will also scrutinise whether Korean vertical regulation can satisfy the various tasks that should be achieved under the perspective of market opening to global competition.

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<sup>6</sup> Art. 1 Japanese AML also illustrates this aim. The idea that Japan could use competition law to achieve economic progress and advance national economic welfare was accepted in 1947 out of an understanding that free competition was good for economic policy. This might influence the Korean regime. See Harry First, 'Antitrust's Goals: Theories of Antitrust in the United States and Japan' in Clifford Jones and Mitsuo Matsushita (eds), *Competition Policy in the Global Trading System*, Kluwer Law International, The Hague, 2002, p. 193.

<sup>7</sup> Art. 1 MRFTA and Art. 119(2) Constitution.

<sup>8</sup> See Dominick Armentano, *Antitrust and Monopoly*, 2nd edn, The Independent Institute, Oakland CA, USA, 1990, p. 40.

<sup>9</sup> Sai Ree Yun and Dae Sik Hong, *Supra.*, note 4. The authors argue that the past development of competition policy is sufficiently evidenced by 3 examples: (i) reduction of concentrations in industries; (ii) reduction of price provided to consumers through the effective regulation of cartel activities; and (iii) increase of economic efficiency and heightened concern for the welfare of the general public through regulatory reforms of deregulation and privatisation.



## 5.2. Purposes of Korean Vertical Regulation Revisited

### 5.2.1. Total Welfare from Vertical Restraints

Article 1 of the Monopoly Regulation and Fair Trade Act (MRFTA) and Article 119(2) of the Constitution clearly state that the aim of competition law is to promote fair and free competition, which mainly focuses on restricting market dominance. By achieving this, competition law can attain the goals of (i) encouraging creative enterprises' activities; (ii) protecting consumers; and (iii) balancing the development of the national economy.<sup>10</sup> Free competition should be the process by which a nation committed to freedom and containment of government can organise its economic affairs efficiently.<sup>11</sup> The MRFTA has been therefore understood as the means to guarantee proper distribution of wealth, to thwart market domination and the abuse of economic power, and to democratise the economy through harmony amongst economic entities. This aim has made the KFTC develop the law to prevent further market dominance at any cost, although its legal provisions may harm the whole economy. This section, therefore, brings some arguments that Korean vertical regulation is objectionable to the aims of total welfare achievement, (i) and (ii) stated above. The next section will consider the application of the law to achieve the aim (iii) balanced economic growth and stable national economy.

First, Korean vertical regulation does not encourage enterprising activities in the market, because it does not provide a sufficient degree of tolerance on vertical restraints that may improve inter-brand competition and efficiency.<sup>12</sup> The regulation strictly curbs efficient vertical arrangements in the market. Along with the concern about market concentration, the law also aims at encouraging enterprises activities overall, including large-scale enterprises. The current law is, however, so strict on vertical restraints that it does not properly implement efficiency-led ideas which may encourage enterprising activities through vigorous inter-brand

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<sup>10</sup> *Supra.*, Chapter 2. See also Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsa, Seoul, 2005, pp. 86-9. Kwon argues that the expression of aims in Art. 1 MRFTA is very unclear and cannot be ultimate objectives of the competition law.

<sup>11</sup> See Harold Demsetz, 'The Trust behind Antitrust' in Eleanor Fox and James Halverson (eds), *Industrial Concentration and the Market System: Legal, Economic, Social and Political Perspectives*, ABA Publishing, USA, 1979, p. 45.

<sup>12</sup> For further discussion of detrimental influence on business activities by vigorous enforcement, see Armando Rodriguez and Malcolm Coate, 'Limits to Antitrust Policy for Reforming Economies', *Houston Journal of International Law*, Vol. 18, 1996, pp. 352-5.

competition. If competition law is very strict on business activities based on the size of the enterprise, despite efficient activities which may reduce transaction costs, it is clear that enterprising activities will be discouraged. This problem can result from the absence of a sufficient and effective presumption of market dominance, based on a market share test that can scrutinise the balance test of inter- and intra-brand competitiveness by vertical restraints.

Second, the current strict rules on vertical restraints do not protect consumers' benefits in the sense of consumer welfare improvement. Some argue that, for instance, exclusionary restraints may harm consumers, where a supplier or distributor has significant market power. This contractual arrangement may be efficient, but the benefits can be at the expense of consumers and, thus, not be socially desirable.<sup>13</sup> The precise meaning of consumer welfare should be discussed, although the recognition of the primacy of consumer interests or consumer welfare is important. It means that the KFTC and the courts implicitly define competition as a process that promotes the welfare of consumers.<sup>14</sup> Under this definition, a practice is anti-competitive only if it harms consumers, and it is pro-competitive only if it benefits consumers. However, which consumers should benefit: consumers in the relevant market or in the economy as whole? Therefore, it is questionable whether the ultimate purpose of competition law is to promote economic efficiency, and thereby benefit consumers in the economy as a whole, or to protect consumers from exploitation.<sup>15</sup> The KFTC seems to be more interested in preventing consumer exploitation than in advancing economic efficiency.

Vertical restraints, however, provide consumers with valuable promotional information and services by decreasing intra-brand competition, which increase inter-brand competition, enhance sales, and thereby increase consumer welfare. Economic approach theorists argue that the benefits to consumers from free-riders with lower prices would be only in the short term.<sup>16</sup> Without intra-brand restraints, the profits resulting from a

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<sup>13</sup> See Patrick Rey and Joseph Stiglitz, 'Vertical Pricing Schemes: Vertical Restraints and Producers' Competition' in Louis Philips (ed), *Applied Industrial Economics*, Cambridge University Press, Cambridge, 1998, p. 189.

<sup>14</sup> For the argument about the process of competition, see Richard Whish, *Competition Law*, 6th edn, Oxford University Press, New York, 2009, p. 1.

<sup>15</sup> See John Kirkwood, 'Consumers, Economics, and Antitrust' in John Kirkwood (ed), *Antitrust Law and Economics*, Elsevier, Amsterdam, p. 29.

<sup>16</sup> Nonetheless, some disagree with this assertion. See Alden Abbott, 'Paradox Regained: Towards a "New Economic Approach" to Vertical Restraints Policy', *The George Washington Law Review*, Vol. 48, 1980, pp.

competitive advantage could be lost.<sup>17</sup> In other words, although consumers may get benefits from free-riding distributors for low price in the short term, it can harm the whole market and result in loss of consumer welfare in the long run. According to Williamson, the social welfare implications can be established by characterising the benefits and costs resulting from market structure. Therefore, the types of trade-offs that competition law must contend with in circumstances where market power and production economies may result in a fair share of efficiency.<sup>18</sup> In conclusion, the consumer welfare implications of most vertical restraints are beyond most competition lawyers and economists.<sup>19</sup> The implementation of law, which emphasises harm to consumers, is therefore wrong, because benefits such as guaranteeing quality of goods and services through vertical restraints will increase social, and also, consumer welfare.<sup>20</sup>

### 5.2.2. Economic Growth and International Trade Improvement from Vertical Restraints

Competition policy should be considered as part of microeconomic and also macroeconomic policies in general, including industrial and trade policies. It cannot be properly viewed in isolation. This general perspective is necessary in order to assess possible conflicts between the instruments of state economic policy, and consider which instruments are most appropriate to which targets of policy. In examining competition policy in terms of overall government policies, competition policy-makers should not only assess market power but also the consequences of regulations on pro-competitive vertical restraints.<sup>21</sup> However, the KFTC hardly considers that the exercise of vertical restraints with some degree of market share may be used for pro-competitive purposes. The current vertical regulation has not been considered as the means of promoting development of national economy. It has been presumed that the achievement of balancing the national economy could be made mostly by

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568-9. Because of imperfections in the market for consumer goods, there is no guarantee that restraints, by providing point-of-sale information and services, will necessarily increase consumer welfare.

<sup>17</sup> See Peter Gerhart, 'The "Competitive Advantages" Explanation for Intrabrand Restraints: An Antitrust Analysis', *Duke Law Journal*, Vol. 1981, No. 3, 1981, p. 426.

<sup>18</sup> E.g. Williamson's 'Naïve Trade-off Model' such as exchange of deadweight loss and cost saving from merger. See Oliver Williamson, 'Economies as an Antitrust Defence: The Welfare Tradeoffs', *The American Economic Review*, Vol. 58, No. 1, 1968, pp. 21-3; Oliver Williamson, *Economic Organization: Firms, Markets, and Policy Control*, Harvester Wheatsheaf, Hertfordshire, 1986, p. 199.

<sup>19</sup> See Frank Easterbrook, 'Vertical Arrangements and the Rule of Reason', *Antitrust Law Journal*, Vol. 53, 1984, p. 153.

<sup>20</sup> For further discussion about quality improvement, see *Supra.*, Chapter 3.

<sup>21</sup> See John Vickers and Donald Hay, 'The Economics of Market Dominance' in Donald Hay and John Vickers (eds), *The Economics of Market Dominance*, Basil Blackwell, Oxford, 1987, pp. 2-3.

protecting SMEs through preventing large firms' practices. Nevertheless, vertical restraints with some degree of market power can improve competition, which may achieve the goal of national economic growth in the end. The KFTC has not sufficiently considered the improvement of international competition and economic growth through vertical restraints. The KFTC outweighs vertical foreclosure and entry barriers over the benefits by vertical restraints.<sup>22</sup> This has created ignorance of pro-competitiveness in the market.

In order to strive for balanced development of the national economy, a policy of international competition should be sought. This cannot be solved by prohibition of large enterprises, nor protection of SMEs, but a fair measure through trade-offs between pro- and anti-competitiveness. Therefore, legislation of competition law should establish a fair trade order without impeding the growth of enterprises.<sup>23</sup> The KFTC should ask the right questions to elicit guidance for achieving the purpose of vertical regulation to achieve balanced economic growth. World trading agreements such as Free Trade Agreements (FTA) normally aim to open markets to trading countries. If government barriers in Korea recede, but the market is still not accessible to efficient foreign firms, there may be blockage by an illegal private restraint.<sup>24</sup>

In the case of monopolistic exclusion, a single firm with dominant power may tie up the only available distributors in order to exclude competitors. In particular, monopolistic exclusion occurs when the dominant firm uses anti-competitive strategies, such as exclusive contracts unnecessary for its own efficiency, in order to fence out rivals. These practices are certainly illegal under the MRFTA, if imposed by firms with market power, and foreclose competitors and raise prices. The problem of market foreclosure by private restraints lies at

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<sup>22</sup> E.g., *Yongsan Chemical Co. Ltd/Korea PTG Co.*, KFTC Decision 2003-154, Sept. 24, 2003. The KFTC examined post-merger effects by vertical foreclosure and entry barrier in a raw material market and concluded there would be anti-competitive outcomes despite the Concentration Ratio (CR) 3 was only 56.2 per cent. There were also several decisions in which the KFTC outweighed foreclosure and entry barrier than efficiency, e.g., *Dongyang Nylon Co. Ltd*, KFTC Decision 96-51, Apr. 22, 1996. For further detail, see also Ohseung Kwon, *Supra.*, note 10, p. 224; Seungwhan Oh, *Gong-Jung-Go-Rae-Sim-Kyoul-So-Whe [Reviews on Decisions of the Fair Trade Commission]*, Sanhakyouun, Seoul, 2005, pp. 58-9.

<sup>23</sup> See Young-Dae Lee, 'How Many Magic Rings: Economic Review of Korean Antitrust Law', *Journal of Korean Competition Law*, Vol. 9, 2003, p. 260.

<sup>24</sup> See Dina Waked, 'Competition Law in the Developing World: The Why and How of Adoption and Its Implications for International Competition Law', *Global Antitrust Law Review*, Issue 1, 2008, p. 89. The author argues openness to trade plays an important role but the lower demand and supply that prevail in developing countries cannot be changed easily with the competition law legislation.

the intersection of trade and competition law,<sup>25</sup> although the KFTC does not seem to consider this. Therefore, the KFTC should be concerned that the law does not prevent pro-competitiveness, and also international transactions by excessively tolerant legal measures. On the contrary, a lenient policy on vertical restraints does not necessarily mean fostering foreclosure against foreign firms. If the KFTC allows only pro-competitive restraints, it would be non-discriminatory, and also improve domestic competition, since efficient foreign firms could penetrate the Korean market. The KFTC therefore needs to balance its implementation of law to improve competition and international trade, which will result in balanced economic growth.

### 5.2.3. Pursuit of Better Vertical Regulation for Purposes of Competition Law Achievement

Korean competition policy has been guided under Article 1 MRFTA to pursue two main objectives: (i) improving domestic market structure that is presumed as dominated by a few enterprises; and (ii) guaranteeing fair trade through prohibiting anti-competitive and unfair practices.<sup>26</sup> The controls on mergers and holding companies under Chapter 3 of the MRFTA can be regarded as a means of achieving the first objective. Articles 3-2, 19, 23, and 29 MRFTA are considered as the legal implementation for the second objective. In observing the Korean distribution system, the KFTC seems to consider it as mostly monopolistic or oligopolistic, with dominant enterprises that inhibit competition or harm consumers through driving out SMEs. The KFTC often concludes that the Korean distribution structure is irrationally multi-levelled, and controlled by a few dominant suppliers. It considers that this distribution system may have some inter-brand competition improvement, but far less intra-brand competition, because big upstream enterprises possibly inhibit competition through vertical control, in order to strengthen their market power in manufacture and final distribution.

When the KFTC examines the balance test, it therefore outweighs intra-brand competition, as analysed in the previous chapter. Within the category of intra-brand restraints,

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<sup>25</sup> See Eleanor Fox, 'Competition Law' in Andreas Lowenfeld, *International Economic Law*, 2nd edn, Oxford University Press, Oxford, 2008, pp. 453-4.

<sup>26</sup> Ohseung Kwon, *Supra.*, note 10, p. 326.

however, market power can be more readily tolerated in some manifestations.<sup>27</sup> Therefore, the question facing the KFTC is how to decide whether particular types of vertical restraints are likely to promote inter-brand competition. This is not a simple task, as this area is the subject of heated debate. Vertical restraints are not always welfare enhancing, nor always anti-competitive. Thus, many agree that there is no one-size-fits-all solution for the issues involving vertical restraints. There are a lot of complex matters involved in designing and implementing regulation, and regulatory reforms at all levels of Korean competition policy. Therefore, it is not easy to give an absolute answer or solution to this problem. However, it is necessary for the KFTC to establish a scrutiny framework, to simplify the analysis of vertical cases to prevent the failures of sound enforcement, because of the increasing importance of vertical arrangements in the market.

It is predictable that for some years, vertical restraints will be the main concern in competition lawsuits. Determining their legality in any given situation is a difficult task when the KFTC does not provide a clear vertical regulation based efficiency from competition. Competition optimises efficiency by inducing better resource allocation. Allocative efficiency is encouraged because investment is directed to the point where the highest returns or benefits exist. Furthermore, the gains from productive or dynamic efficiency through innovation, which competition fosters, enables the state economy to cope with global economic changes. The welfare and efficiency impact of competition are generally recognised as the main objectives of competition policy in most countries. Therefore, competition policy should promote competition, as long as it encourages efficiency and growth. In addition, competition policy should be consistent with non-economic objectives, such as consumer protection. These principles are, of course, more easily stated than applied in practice. These objectives can conflict with efficiency objectives, and the trade-offs are often difficult to resolve.<sup>28</sup>

Whilst the divergent economic theories are useful in shaping analysis of vertical cases, the KFTC should move beyond a purely theoretical model, and reduce the conflict between legal and economic abstractions to a more practical level, to determine the proper application

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<sup>27</sup> See Lawrence Sullivan and Warren Grimes, *The Law of Antitrust: An Integrated Handbook*, 2nd edn, Thomson West, St. Paul MINN, USA, 2006, p. 30.

<sup>28</sup> Some scholars argue that consumer welfare effect test rather than trade-off test gives benefits such as fewer potential errors in implementation. See Steven Salop, 'Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard', *Antitrust Law Journal*, Vol. 73, 2006, pp. 313-4.

of law.<sup>29</sup> In conclusion, the KFTC has two main tasks in its policy on vertical restraints: (i) to ensure that no economic entity can abuse its power; and (ii) to implement rules that would increase efficiency without any failure of the market to perform its function. In most instances, these rules may simply be about making the market more competitive, and prohibiting and disciplining clear restraints to trade. Where market power is inherent in the market structure, competition policy should prevent use or abuse of such power. This should require enforcing rules to guide economic entities not to abuse market power, and also improve efficiency.<sup>30</sup> An improvement in vertical regulation based on more efficiency-focus will ensure balance of the purposes of competition law.

### 5.3. Harmonising Purposes of Competition Law on Vertical Restraints: Practical Matters

#### 5.3.1. More Efficiency, More Gains

It is not an easy task for the KFTC to develop the law where there are various aims to be achieved under certain conditions.<sup>31</sup> Moreover, it is sometimes difficult to apply an economics-first policy. Although economists have demonstrated the importance of economic justification regarding vertical restraints, efficiency-improvement cannot be the only purpose of Korean competition law. Therefore, it would be too hasty to jump from the foregoing theoretical analysis to a consideration of policy based on efficiency in practice without first discussing what may be termed ‘trade-offs’. Competition policy should pursue the trade-off between the costs and benefits of various types of policy measure. In practice, policy-makers obviously have neither the power nor the information to bring about the optimal outcome from vertical restraints. However, they cannot ignore that trade-off is an essential part of the competitive market system. The question is, then, how best to promote and maintain the process of effective competition. The effects of competition and policy measures upon welfare are often ambiguous. It is not possible to deduce clear-cut results by theorising. Therefore, the factors in the real market do matter. However, when one considers the

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<sup>29</sup> Courts should examine cases not only by economic theories. For further discussion, see Wanda Roger, ‘Beyond Economic Theory: A Model for Analyzing the Antitrust Implications of Exclusive Dealing Arrangements’, *Duke Law Journal*, Vol. 45, No. 5, 1996, p. 1011.

<sup>30</sup> See Erlinda Medalla, ‘Perspectives on Competition Policy: an Overview of the Issues’ in Erlinda Medalla (ed), *Competition Policy in East Asia*, Routledge, London and New York, 2005, pp. 4-5.

<sup>31</sup> Dina Waked, *Supra.*, note 24, p. 70.

appropriate design of competition policy, it is unsatisfactory to say that it all depends on the particular circumstances at hand, and every case must be investigated in detail on its merits. Since competition policy is costly to administer, especially in a country without a common law tradition, the costs of in-depth investigations of every case would outweigh the possible gains. In a common law system such as the US, the courts develop antitrust policy,<sup>32</sup> although the weakness of the common law approach to competition law is its legal uncertainty.<sup>33</sup> The MRFTA is, however, the outcome of the civil law tradition. Korean vertical regulation, therefore, should be a set of rules and criteria that provide comprehensive examinations to give certainty. The first task should be reform for enhancing legal certainty in order to ensure efficiency in vertical regulation. Nevertheless, the KFTC should not ignore the benefits from flexible rule of reason enforcement from the common law antitrust.

The current law and policy highlights protection of consumers and SMEs rather than efficiency. This implementation has been criticised because of its protection of competitors, despite its inefficient outcome<sup>34</sup> based on the unfairness concept.<sup>35</sup> The KFTC should guarantee the principle of protection of competition rather than competitors. However, this is often ignored. Therefore, the KFTC needs to trade-off the positive and negative impacts by vertical restraints in order to reach the level of a mature market economy, rather than protection of SMEs. Vertical restraints can be beneficial to the economy where these arrangements can guarantee quality of goods, stabilise supply of goods, and prevent free-riding. To consolidate the harmonisation or trade-off of competition goals regarding vertical restraints, the KFTC needs to shift its policy from the protection of consumers and SMEs to efficiency-improvement. Trade-off, the sacrifice of one aim to gain another, may be proper. Competition law devoted entirely to consumer welfare faces severe trade-off problems.<sup>36</sup> Therefore, more efficiency-focus provision in a developing country's economy will give more benefits than other social objectives.

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<sup>32</sup> See Phillip Areeda, Louis Kaplow, and Aaron Edlin, *Antitrust Analysis: Problems, Text, and Cases*, 6th edn, Aspen Publishing, New York, 2004, p. 3.

<sup>33</sup> See Philip Areeda, 'Monopolization, Mergers, and Markets: A Century Past and the Future' *California Law Review*, Vol. 75, No. 3, 1987, p. 981.

<sup>34</sup> See Kwangshik Shin, 'Kyoung-Jae-Wi-Ki-Wa-Kyoung-Jaeng-Jeong-Chaek (Economic Crisis and Competition Policy and Law)' *Journal of Economic Policy*, Vol. 20, No. 1 and 2, 1998, p. 35. The author argues Korean competition enforcement for protection of competitors may cause inefficiency outcome.

<sup>35</sup> See Hyun-Ok Han, 'Bul-Gong-Jung-Go-Rae-Haeng-Wi-Ui-Wi-Bub-Sung-Pan-Dan (Scrutiny of Infringement of Unfair Business Practices)' in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, p. 447.

<sup>36</sup> See Robert Bork, *The Antitrust Paradox: A Policy at War with Itself*, The Free Press, New York, 1993, p. 79.



### 5.3.2. Criteria for Trade-Off Test

The views on trade-off here reflect the following principles. First, policy should be framed with a view to minimise the cost of error, such as condemning desirable behaviour and permitting undesirable behaviour. Therefore, vertical regulation and guidelines are necessary to not make this error. Second, although competitive outcomes from vertical restraints are sometimes disadvantageous, the process of balancing of inter- and intra-brand competition is the most workable system for achieving the purposes of competition law. This may mean that the major concern of competition policy on vertical restraints should be the promotion and maintenance of the process of pro-competition and efficiency. However, that should not be the only concern of competition policy, because in some vertical cases it might be possible that the decrease of intra-brand competition is outweighed by market dominance. These considerations should be taken into account, but the burden of proof lies with those arguing that the lessening competition should be outweighed by efficiency. This test has been often practised in vertical merger cases, but not very often in vertical restraints.<sup>37</sup> Third, it would be wrong to condemn vertical restraints without reason to believe that effective competition is absent, or would be absent if the conduct were permitted.<sup>38</sup> Therefore, vertical restraint should be subject to investigation only if it appears that it might jeopardise competition. If it is found not to threaten competition, it should be allowed. To provide legal certainty in vertical restraints to enhance positive outcomes, the KFTC needs to revise a sound presumption of market dominance.

Vickers and Hay suggest four criteria to be taken into account in determining the public interest from effective competition, and this can give an idea for Korean regulation.<sup>39</sup> These are (i) preventing exercise of market dominance that inhibits competition; (ii) promoting the interests of consumers in respect to the quality and variety of goods and

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<sup>37</sup> The efficiency outcome should be greater than the anti-competitive in the scrutiny under sec. III.2 of the Guidelines for review M&A, Notification No. 2007-12 amended on Dec. 20, 2007. The burden of proof lies on parties, i.e., *Hyundai Motors-Kia Motors/Wia Corp.* KFTC Decision 2002-111, 2002Kikyoul0610, June 18, 2002; *Hite Beer Corp./Jinro Corp.*, KFTC Decision 2006-009, 2005Kikyoul1484 and 2005Kikyoul2725, Jan. 24, 2006. The KFTC blocked these mergers since there was no sufficient proof of whether efficiency outcome from the mergers outweighed the anti-competitive effects.

<sup>38</sup> These conditions are discussed by Vickers and Hay. John Vickers and Donald Hay, *Supra.*, note 21, p. 19.

<sup>39</sup> *Ibid.*, p. 29. This suggestion was inspired from the authors' illustration of sec. 84 of the Fair Trading Act 1973 of the UK.

services by preventing free-riding; (iii) reducing transaction costs and developing a new distribution and facilitating market entry, thereby enhancing inter-brand competition; and (iv) maintaining and promoting the balanced distribution of goods and services. The most important element of the criteria to be measured by the KFTC is to examine and weigh the various elements of the public demands. This should be a protection-of-competition way rather than competitors. The Unfair Business Practice (UBP) provision has been considered as a critical means of protecting competitors, trading partners, and also competition.<sup>40</sup> This mixed concept is confusing, as to whether the aim of the UBP provision is to protect competitors rather than competition.

The KFTC should be concerned about market conduct when scrutinising the UBP provision only if effective competition in the domestic market does not work properly, and this should be done through economic ideas. Although there are some limits of on the use of economics in competition analysis,<sup>41</sup> the influence of economic thinking upon competition policy worldwide has grown considerably. Moreover, recent vertical restraint cases have been greatly influenced by the development of economic theory. Hence, defining proper standards regarding the illegality of vertical restraints is a global subject, which needs international comparative analysis.<sup>42</sup> The preceding section demonstrates that the KFTC is not well equipped with a sound law for efficiency-improvement, unlike the US and the EC, as discussed in Chapter 3. This is because of the divorce of policies in its theory and practice of competition law in the context of global competition. Concern about international competition in vertical restraints should be observable. Therefore, the KFTC needs to consider and examine other competition regimes' vertical regulations, along with economic theories to assure benefits from vigorous competition. As a final point, the KFTC should be properly concerned about social interests. The fate of individual competitors, regardless of whether they are domestic or international, is relevant only as far as this relates to an assessment of whether the competitive process is operating in a reformed method for general

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<sup>40</sup> See Yunjeong Kim, 'The Meaning of Consumer Protection as the Purpose of the Korean Antitrust Act' *Journal of Korean Competition Law*, Vol. 14, 2006, p. 310.

<sup>41</sup> Lawrence Sullivan and Warren Grimes, *Supra.*, note 27, p. 20. The economic analysis is limited because (i) economic ideology is an evolving and incomplete source; (ii) many conclusions by leading economists are not a matter of consensus, and some are highly controversial; and (iii) the assumptions that underlie economic analysis are often difficult or impossible to prove in an agency investigation or litigated cases.

<sup>42</sup> See Toshaki Takiagawa, 'A Comparative Analysis of U.S., EU, and Japanese Microsoft Cases: How to Regulate Exclusionary Conduct by a Dominant Firm in a Network Industry', *The Antitrust Bulletin*, Vol. 50, No. 2, 2005, p. 266.

public interest.<sup>43</sup> This should be the ultimate aim, the idea of trade-off in implementation of vertical regulation. The vital groundwork for this test is proper provision from clear guidance.

#### 5.4. Market Power in Korea: Special Responsibility vs. Efficiency in Korean Vertical Cases

##### 5.4.1. Problems of Market Power and Competition in Vertical Level

The theme of this section focuses on market power at the vertical level, such as the power of a single enterprise over the distribution of goods or services in a market. Monopolistic market structure and its consequences have been a critical topic as part of established economic analysis for a long time. As a result, the KFTC has devised monopoly policies to deal with them in practice. Nevertheless, monopolies in the real world do not always fit the theoretical categories, and their persistence in the face of competition policies brings concerns about negative consequences generally.<sup>44</sup> This argument about policy on large enterprises has been a problem in Korea, with its traditionally inadequate policy on monopolies. In particular, the important question relating to vertical restraints is how far the KFTC can exempt vertical restraints of enterprises with some degree of market power. The next question shall be how much market share of enterprises practising vertical restraints can be regarded as pro-competitive rather than harmful to competition. This can be resolved through the economic rationale of vertical restraints, as well as a sound presumption of market dominance. Market power is commonly defined as the ability to raise and maintain price or reduce outputs significantly without losing profits. In particular, the term ‘market dominant enterprise’ under Article 2(7) MRFTA is defined as any enterprise holding market dominance who can determine, maintain, or change the prices, quantity or quality of goods and services or other terms and conditions of business.

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<sup>43</sup> See Oliver Williamson, *Antitrust Economics: Mergers, Contracting, and Strategic Behavior*, Basil Blackwell, Oxford, 1987, p. 300; Masako Wakui, *Antimonopoly Law: Competition Law and Policy in Japan*, Arima Publishing, Suffolk, 2008, pp. 41-2. This public interest problem in competition law has been also discussed in Japan. However, the Japanese cases seemed a more likely justification for consumer safety rather than impacts by competition, e.g., *Oil Cartel*, Supreme Court of Japan, Feb. 24, 1984, *Saiko Saibansho Keiji Hanreishu (Keishu)* 38-4-1287; *Toshiba Elevator*, Osaka High Court, July 30, 1993, *Shinketsushu* 40-651.

<sup>44</sup> John Vickers and Donald Hay, *Supra.*, note 21, p. 1.

Most enterprises, in fact, have at least some degree of market power, because their products are not perfectly interchangeable with the goods of others. However, few enterprises have substantial market power over price. Therefore, enterprises without significant market power cannot harm competition, no matter how much they try. They may harm a few consumers or competitors by selecting anti-competitive strategies. When enterprises lack market power, they cannot sustain harmful activities.<sup>45</sup> The possibly anti-competitive forms of vertical restraints can occur only if there is significant market power. Vertical arrangements with such market power may also facilitate cartels to make collusion plausible.<sup>46</sup> Monopolistic enterprises under collusive conduct may raise rivals' cost of entry as foreclosure. Where there is no market power, however, many entrants stand ready to supply goods.<sup>47</sup> Therefore, it is crucial to assess the market power of an enterprise, along with scrutinising pro- and anti-competitive effects by vertical restraints. In other words, large enterprises in Korea should take their special responsibilities in vertical cases only when they have significant market power. The important assignment of the KFTC is thus to establish a proper market share threshold to prevent abuse of dominance.

#### 5.4.2. Pressure of Competitive Rivalry in Vertical Relations: *Ex Ante* Approach

If a market is open to international competitors without any state-regulatory barriers, efficiency-seeking behaviour will increase, regardless of the size of enterprises. Despite its perspective of market opening to Korea, however, assessing market power is still important. That is because the consequences of market opening are sometimes ambiguous as to whether they will lead to vigorous competition or not. This ambiguity may create a considerable cost. Then, regarding the economic analysis of conditions of sale at the vertical level, there are two distinct questions<sup>48</sup> whether: (i) the practices with some degree of market power are harmful to competition or to social welfare generally; (ii) these are indicative of a lack of effective competition in the Korean market. To solve the first question, it is necessary to examine the relevant provisions of vertical restraints with market power, the implementation of Article 3-

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<sup>45</sup> Frank Easterbrook, *Supra.*, note 19, p. 159.

<sup>46</sup> See Harold Demsetz, 'Industrial Structure, Market Rivalry, and Public Policy', *Journal of Law and Economics*, Vol. 16, No. 1, 1973, pp. 6-7; Richard Posner, 'Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions', *Columbia Law Review*, Vol. 75, No. 2, 1975, p. 292. However, the authors argue that it does not seem to support the notion that concentration and collusion are closely related, for instance, where consumers are highly mobile.

<sup>47</sup> Frank Easterbrook, *Supra.*, note 19, p. 160.

<sup>48</sup> John Vickers and Donald Hay, *Supra.*, note 21, p. 5.

2. The general legal standards applicable to abuse of dominant position indicate that vertical restraints by a dominant enterprise are highly likely to be exclusionary. The problem with this is that competition authorities in the world fail to explain which of the exclusions impede competition, and which to condemn. If an enterprise has attempted to inhibit competition with an intention other than efficiency, it is fair to categorise its behaviour as anti-competitive abusive conduct.<sup>49</sup> On the contrary, overaggressive use of competition enforcement against exclusionary conducts will inevitably reduce the incentive for beneficial competition.<sup>50</sup> This concern has not been clearly discussed in the Article 3-2 cases. Moreover, the KFTC has not made clear that efficiency is the normative standard rather than just one factor in determining whether a justification is valid. Hence, it is crucial to provide sound guidance on how large market power can impede competition. Without this, it is difficult to obtain welfare gain.

The second question of lack of effective competition from the vertical cases should be scrutinised under the *ex ante* approach. By exclusive dealing with market power, for example, an enterprise reduces the size of the entrants' potential market, so that the probability of entry will decrease. As a result, consumers may have to accept higher prices.<sup>51</sup> This rationale can often be observed in current KFTC decisions such as the *Intel* case.<sup>52</sup> The KFTC decided that *Intel* abused its dominant position, thereby drove out its rival, *Advanced Micro Devices (AMD)* from the Central Processing Unit (CPU) market. In this case, *Intel* offered rebates in exchange for exclusive deals with the Korean computer makers,<sup>53</sup> *Samsung Electronics* and *Sambo computers*, which rank first and second respectively in the Korean market. The KFTC focused on *Intel's* market share, approximately 90 per cent, which was even higher than its worldwide market share, 79.6 per cent. The KFTC held that *Intel's* action forced domestic manufacturers to buy the expensive CPU from it, causing consumers to pay higher prices.<sup>54</sup> It

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<sup>49</sup> See Einer Elhauge and Damien Geradin, *Global Competition Law and Economics*, Hart Publishing, Oxford, 2007, p. 367.

<sup>50</sup> See Dennis Carlton, 'A General Analysis of Exclusionary Conduct and Refusal to Deal: Why Aspen and Kodak Are Misguided', *Antitrust Law Journal*, Vol. 68, 2001, p. 660.

<sup>51</sup> See Philippe Aghion and Patrick Bolton, 'Contract as a Barrier to Entry', *The American Economic Review*, Vol. 77, No. 3, 1987, p. 396. The KFTC could have considered predatory intent such as short-run loss for long-run exercising market power for future recoupment. For further discussion about game-theoretic assumption of predation, see also John R. Lott, Jr., *Are Predatory Commitments Credible? Who Should The Courts Believe?*, The University of Chicago Press, Chicago and London, 1999, Ch. 2.

<sup>52</sup> *Intel Corp., Intel Semiconductor Ltd, and Intel Korea*, KFTC Decision 2008-295, 2007Dokgam1790 and 2008Sijang1126, Nov. 5, 2008.

<sup>53</sup> This case is similar to the EC rebate case, *Hoffman-La Roche & Co AG v Commission*, Case 85/76, [1979] ECR 461, [1979] 3 CMLR 211. For further discussion, see Richard Whish, *Supra.*, note 14, pp. 720-21.

<sup>54</sup> The average price of PC of *AMD's* CPU was lower by 10 per cent than that of *Intel*.

focused on market power of a single brand and the negative effects by restraints on consumers and the domestic market. The KFTC stressed that one of the major positive outcomes from its decision was the increased opportunity for consumers to select from a greater variety of products.<sup>55</sup> This consumer-welfare-focused rationale was very similar to that in the 2005 *Intel* decision by the Japan Fair Trade Commission (JFTC), for its foreclosure through exclusive dealing by means of a rebate, a volume discount.<sup>56</sup> In the *Intel* cases in Korea and Japan, *AMD* sold CPUs at a lower price than *Intel* thereby increasing its market share, and *Intel* merely reacted by means of the rebate practice in order to maintain the highest ratio of CPU adoption in the PC market. When a dominant firm decides to respond to its rival, competition law can be a flexible potential method to protect competition.<sup>57</sup>

It seemed, however, that the KFTC focused on total market foreclosure, such as ‘market containment effects’, which block market entry into the Korean market. Its argument of which vertical restraints may impede entry, by requiring entrants to have some degree of market power, was wrong. Anti-competitive outcomes should be decided depending on the condition of downstream level market concentration. Although the Korean PC makers at the downstream level had certain market power, they had a large number of foreign rivals, such as *Sony* and *Toshiba* etc. In other words, this rebate could increase price competition at the downstream level.<sup>58</sup> Furthermore, *Intel*’s exclusive practice could increase efficiency by secure contractual tie-ins. This rationale illustrates economic advantages of vertical control of rigid long-term contracts, to supplement limited reputational capital to recoup Research and Development (R&D) investment.<sup>59</sup> The KFTC did not distinguish the harm to competitors from harm to competition. Consumers could get benefits from the introduction of new

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<sup>55</sup> See KFTC, *Newsletter*, Issue 8, July 4, 2008, p. 16: [http://eng.ftc.go.kr/bbs.do?command=getList&type\\_cd=10](http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=10) (accessed 11 March 2009).

<sup>56</sup> *Intel K.K.*, JFTC Decision, Apr. 13, 2005, *Shinketushu* 52-341.

<sup>57</sup> See Andrew Gavil, ‘Exclusionary Distribution Strategies By Dominant Firms: Striking A Better Balance’, *Antitrust Law Journal*, Vol. 72, 2004, pp. 80-81. However, the author also argues that there will be no competition without competitors.

<sup>58</sup> See Christian Ahlborn and David Bailey, ‘Discounts, Rebates and Selective Pricing By Dominant Firms: A Trans-Atlantic Comparison’ in Philip Marsden (ed), *Handbook of Research in Trans-Atlantic Antitrust*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p. 202.

<sup>59</sup> This could also be transaction-specific investments that create the incentive for vertical integration. For further discussion, see Benjamin Klein, ‘Fisher-General Motors and the Nature of the Firm’, *Journal of Law and Economics*, Vol. 43, No. 1, 2000, p. 105; David Evans and Michael Salinger, ‘Why Do Firms Bundle and Tie? Evidence From Competitive Markets and Implications For Tying Law’, *Yale Journal on Regulation*, Vol. 22, 2005, pp. 37-89.

products in the new economy,<sup>60</sup> where the monopoly profit expected from innovation creates an incentive to provide the gain to society.<sup>61</sup> Since the downstream market was quite competitive, the KFTC could have considered *ex ante* vigorous competition in this new economy. The anti-competitive effects from *Intel*'s practice can also be plausible, based on economic theories. As argued in the *Microsoft* tying case<sup>62</sup> in the previous chapter, the presence of economies of scale and network effects is the central feature of models of anti-competitive tying and exclusionary contracts in technological products. This implies that depriving a rival of sales can weaken its future competitiveness. Given this point, *Intel* and *Microsoft* might accomplish this goal profitably using exclusionary and predatory practices.<sup>63</sup> However, the KFTC did not consider the balance of theoretical debates.<sup>64</sup>

The KFTC disregarded the unique technology environment, and the necessity of exclusive dealing for the reduction of transaction cost. Furthermore, it did not fully discuss even whether these firms intended to drive out their rivals through anti-competitive strategies, or whether their rivals were harmed because *Intel* and *Microsoft* were highly efficient.<sup>65</sup> The KFTC focused on fear of largeness and consumer protection, rather than the rivalry in the market. In short, its decision may have been right, but its reasoning was wrong. If a foreign monopolist has exclusive dealing contracts with domestic firms, the distribution network is

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<sup>60</sup> For discussion about the new economy and also network effects by exclusive dealing, see Steven Salop and Craig Romaine, 'Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft', *George Mason Law Review*, Vol. 7, 1999, p. 638; Richard Posner, 'Antitrust in the New Economy', *Antitrust Law Journal*, Vol. 68, 2001, pp. 925-43.

<sup>61</sup> Dennis Carlton, *Supra.*, note 50, pp. 671-5.

<sup>62</sup> *Microsoft Co.*, KFTC Decision 2006-042, 2002Kyoungchok0452 and 2005Kyoungchok0375, Feb. 24, 2006.

<sup>63</sup> See Michael Whinston, 'Exclusionary and Tying in U.S. v. Microsoft: What We Know, and Don't Know', *The Journal of Economic Perspectives*, Vol. 15, No. 2, 2001, p. 73; Einer Elhauge, 'Defining Better Monopolization Standards', *Stanford Law Review*, Vol. 56, No. 2, 2003, p. 292. The sacrifice of short-term profits in *Intel* case should have been the important factor to decide whether it is anti-competitive.

<sup>64</sup> Einer Elhauge, *Ibid.*, pp. 318-9. The author, however, argues that in the 2001 US *Microsoft* case [*United States v. Microsoft Corp.*, 253 F. 3d 34 (D.C. Cir. 2001) (en banc), *cert. denied*, 534 US 952 (2001)] the technological benefit was a certainly a pro-competitive benefit but did not really eliminate the anti-competitive effect. For further discussion, see also David Evans et al, *United States v. Microsoft: Did Consumers Win?*, *Journal of Competition Law and Economics*, Vol. 1, No. 3, 2005, pp. 497-539; Mark Popofsky, 'Defining Exclusionary Conduct: Section 2, The Rule of Reason, and The Unifying Principle Underlying Antitrust Rules', *Antitrust Law Journal*, Vol. 73, 2006, pp. 444-5.

<sup>65</sup> See Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, republished edition, Harper & Row Publishers, New York, 1975, pp. 98-106; Robert Levinson, 'Efficiency Lost?: The *Microsoft* Consent Decree' in Malcolm Coate and Andrew Kleit (eds), *The Economics of the Antitrust Process*, Kluwer Academic Publishers, Norwell MA, USA, 1996, p. 177. Monopolies can arise as the result of a competitive process, and the rents earned by such monopolists are the prize for superior innovation or business efficiency. However, there are some arguments regarding innovation incentives in the new economy. See also Jonathan Baker, 'Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation', *Antitrust Law Journal*, Vol. 74, 2007, p. 591.

foreclosed to a potential entrant for only a short-term.<sup>66</sup> What is basically required for contracts to constitute a barrier to entry as an indication of a lack of competition should be the post-entry profits for the incumbent, in other words, based on an *ex ante* analysis.<sup>67</sup>

If the *AMD* PC products of foreign rivals are competitive in the Korean market, the KFTC does not have to be concerned about market foreclosure. Under this *ex ante* examination, the KFTC can measure the degree of lack of effective competition in vertical cases, and properly implement the law. The problem is not only the lack of enforcement experience, but also unclear statements in the MRFTA.<sup>68</sup> Where business practice in the new economy brings obvious consumer welfare,<sup>69</sup> the KFTC and the courts should examine the restriction of intra-brand competition, and do a balance test.<sup>70</sup> The current approach of the KFTC on leverage effects by tying or any other methods through market power seems stringent, although market shares are likely to lack predictive power when innovation is rapid in the new economy.<sup>71</sup> In the *SK Telecom Corp.* case,<sup>72</sup> for example, the KFTC focused on the firm's market share, 60.2 per cent, rather than *ex ante* competition in the internet download market. There is always the possibility that a new product can replace the old one through vigorous rivalry in this new economy. However, it was not fully considered *ex ante* in the current cases.<sup>73</sup>

#### 5.4.3. Consideration for Global Standard: More Economic Notes

Vertical restraints are usually pro-competitive, especially when these practices permit enterprises to compete on the level of global distribution as well as on the traditional terms of

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<sup>66</sup> Frank Easterbrook, *Supra.*, note 19, p. 162.

<sup>67</sup> Philippe Aghion and Patrick Bolton, *Supra.*, note 51, p. 399.

<sup>68</sup> E.g., sec. V.5.A.(1)(A) of the UBP Guidelines (tie-in sales) illustrates that the KFTC examines the violation of tie-ins based on trends of technological innovation and product integration. However, this statement is not sufficient to guide the new economy issue. Moreover, there has not been any relevant case.

<sup>69</sup> For further discussion, see John Lopatka and William Page, 'Monopolization, Innovation, and Consumer Welfare', *George Washington Law Review*, Vol. 69, 2001, p. 424.

<sup>70</sup> See Seung-Wha Chang, 'Violation Criteria of Tying under the Monopoly Regulation and Fair Trade Act', *Seoul University Law Journal*, Vol. 45, No. 4, 2004, p. 516.

<sup>71</sup> See Richard Schmalensee, 'Antitrust Issues in Schumpeterian Industries', *The American Economic Review*, Vol. 90, No. 2, 2000, p. 193.

<sup>72</sup> *SK Telecom Corp.*, KFTC Decision 2007-044, 2006Sokyoung0785, Feb. 6, 2007.

<sup>73</sup> E.g., *SK Telecom Corp.*, KFTC Decision 2001-183, 2001Kyoungchok1955, Oct. 8 2001. *SK* lost its market share in mobile phone industry significantly from 84.1 per cent to 41.9 per cent during the years 1997 to 2000.



intermediary and final goods in the global market.<sup>74</sup> The more ways enterprises compete in the global market, the better they improve the state economy, thereby enhancing competition in the domestic market. Therefore, vertical restraints almost never threaten competition without significant market power in the context of the market opening to international competitors.<sup>75</sup> If, however, the exercise of dominance tends to be detrimental to competition other than competitors, it should be a *prima facie* anti-competition case.<sup>76</sup> Following this general economic consideration, the KFTC should prepare for a clear degree of efficiency-enhancing policy on vertical restraints to meet a global standard where there is no harmonised competition law in the international perspective. There are two plausible suggestions to achieve the goal of meeting a global standard. The first is to attempt to balance the welfare gain from vertical restraint, and the welfare loss from market power. The second is that of inferring the cause of an enterprise's market power. To achieve the second one effectively, the KFTC should consider whether the maintenance of a dominant position by means of exercise of vertical restraints is anti-competitive. Potential competition from the entry and expansion of international rivals has always been regarded in competition law studies. Dominance would rapidly be eroded by these international competitors if domestic large enterprises became inefficient when the market is open to foreign enterprises. Therefore, domestic enterprises must be encouraged not to abuse their market power if the potential competition from foreign enterprises is strong.<sup>77</sup>

Some may argue about collusive problems by vertical restraints in the Korean market, in which foreign wholesalers have not successfully gained profits. Cartels are unlawful per se, and should remain so under Article 19 MRFTA. However, vertical restraints are not often used by cartels, and most vertical restraints are just a means by which one supplier competes with others.<sup>78</sup> In particular, if there are more routes to distribute for international competitors, an increase in social welfare will be expected. The only reason why foreign wholesalers are not successful in the Korean market is their marketing failure.<sup>79</sup> In the evolution of mass

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<sup>74</sup> See David Fidler, 'Competition Law and International Relations', *The International and Comparative Law Quarterly*, Vol. 41, No. 3, 1992, pp. 572-3.

<sup>75</sup> Frank Easterbrook, *Supra.*, note 19, p. 168.

<sup>76</sup> John Vickers and Donald Hay, *Supra.*, note 21, p. 9.

<sup>77</sup> *Ibid.*, pp. 11-4.

<sup>78</sup> Frank Easterbrook, *Supra.*, note 19, p. 135.

<sup>79</sup> See Wan-Soon Kim and You-il Lee, *The Korean Economy: The Challenges of FDI-led Globalisation*, Edward Elgar, Cheltenham, UK, 2007, pp. 87-90. A number of large discount wholesalers, *Carrefour*, *Tesco* (*Homeplus: Samsung-Tesco*), *Wal-Mart*, and *Costco* have set up their businesses in Korea. However, except *Tesco*, these

production and mass distribution interaction, the vertical mobility of most distribution functions and operations is very high today, with developed countries witnessing the consolidation of new methods of doing business both at up- and downstream levels.<sup>80</sup> However, this industrial change cannot be harmful to competition. Therefore, the Korean competition authority needs to consider the overall economic circumstances and market structure, based on more economic analyses from global competition.<sup>81</sup>

## 5.5. Statutory Problems in Korean Competition Law and Policy on Vertical Restraints

### 5.5.1. Overview of Problems in Substantive Statutes

Following the understanding of aims of the Korean competition policy along with market dominance issues, it is necessary to examine whether the current legal provisions on vertical restraints are suitable to achieve the purposes of the law. This section contains an evaluation of the framework of the Korean competition law of vertical restraints. The evaluation is based on the principles of purposes set out in the previous chapter. This section concludes with a consideration of three main issues: (i) double standards of scrutiny under Articles 3-2 and 23 MRFTA, grounded mainly in the wrongful presumption test of market dominance in Article 4 MRFTA; (ii) confusion in application of Articles 19 and 23 MRFTA, which was already discussed in Chapter 4; and (iii) improper legal provisions to implement the Resale Price Maintenance (RPM) law, Article 29 MRFTA, of per se rule. Korean competition law overall has been motivated by microeconomic considerations of efficient resource allocation and effective competition. In addition, macroeconomic concerns, such as international competitiveness and economic growth, have been adopted.<sup>82</sup>

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distributors did not make a significant success. For example, in 2006 *Carrefour* withdrew from Korea for its maladjustment to local consumer tastes and challenges from competitors.

<sup>80</sup> See Antonio Cucinotta, 'The Vertical Price Fixing Controversy' in Antonio Cucinotta, Roberto Pardolessi, and Roger Van den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, p. 264.

<sup>81</sup> See Kwangshik Shin, *Innovating Korea's Competition Policy*, Nanam Publishing, Seoul, 2006, p. 117. The author argues that the KFTC's specialisation by economic analysis can improve its extraterritorial application, and this will protect consumers from anti-competitive practices by foreign firms.

<sup>82</sup> The administrative policy of competition with macroeconomics has its long history. For example, a statute concerning price stability was legislated in the 1970s, the Price Stabilisation and Fair Trade Act (Law No. 2798, Dec. 31, 1975). This macroeconomic concern can be also observed in the merger control. Under Art. 7(2)1 MRFTA and sec. VIII.1 of the Guidelines for review M&A [amended by KFTC notification No. 2007-12, Dec. 20, 2007] (efficiency defence), the KFTC allows mergers that may contribute to the efficiency on the national

Accordingly, a loose and wide-ranging concept of total welfare was laid down by the MRFTA as the criterion by which the KFTC was to assess the effects of exercise of market dominance. However, the MRFTA on vertical restraints (vertical regulation) has not fully developed in its implementation, because it is very often curbed by the fear of large companies. The MRFTA offers the provision to measure market power regarding vertical restraints. Dominance exists in relation to a relevant market and the enquiry into market power. Therefore, the examination of dominance becomes central. The enquiry into dominance becomes divided into two parts: (i) relevant market definition; and (ii) investigation of dominance in that market. Once market dominance has been established under Article 4 MRFTA, there is the question of whether abuse has occurred. Therefore, without dominance, there cannot be abuse. If the enterprise does not belong to the category of market dominance, its practices may be scrutinised under Article 19, 23, or 29, regardless of market power. The KFTC tries to provide an illustration of the increasing importance of economics in the formulation of Korean competition policy regarding vertical restraints through the Market Dominance Guidelines and the UBP Guidelines. However, these do not clearly explain how far enterprises can use their power in the market, since the provision is obscure in its scope of application based on market share.

#### 5.5.2. Double Standard on Vertical Restraints: Article 3-2 or 23 of the MRFTA?

##### 5.5.2.1. Comparison between Articles 3-2 and 23 of the MRFTA

If vertical restraints are pro-competitive most of the time, what is the appropriate course for competition policy? Certainly recognition of the competitive benefits of practices means elimination of per se condemnation, which is reserved for practices that are always anti-competitive. The usual alternative to condemnation of a per se is evaluation of vertical restraints under the rule of reason.<sup>83</sup> The common criterion of measuring the pro- and anti-competitiveness for a rule of reason development is, therefore, assessing market power of an enterprise as stated in the *Dairy Association* case.<sup>84</sup> In this case, the Constitutional Court<sup>85</sup>

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economy such as: (i) job creation; (ii) development of regional economy; (iii) development in supply chain; (iv) stability of national supply (energy); and (v) elimination of pollution.

<sup>83</sup> Frank Easterbrook, *Supra.*, note 19, p. 153.

<sup>84</sup> *Dairy Association v KFTC*, Constitutional Court of Korea 2005Heonma1209, Dec. 27, 2007.

clarified that the firm did not infringe Article 3-2 because its market share was far less than 50 per cent, and could not satisfy market dominance presumption under Article 4. It was confirmed that, if an enterprise does not have significant market power, its vertical practice may give pro-competitive benefits. However, where the market power of the enterprise is significant, the probability of anti-competitiveness from its practices increases.

Article 3-2 prohibits abusive conduct of a market dominant position. Therefore, it overlaps the scope of Article 23 in vertical cases such as; (i) refusal to deal, (ii) exclusive dealing, (iii) territorial restriction, and (iv) tie-in sales. This overlap problem stems from the influence of the Japanese Antimonopoly Law (AML).<sup>86</sup> This overlap also occurs in the Japanese system, because the UBP provision in the AML rests vague regarding vertical arrangements.<sup>87</sup> In particular, Article 3-2 MRFTA has its model from the first half paragraph of Article 3 AML in its prohibition of abuse of market dominance,<sup>88</sup> and its similarity to Article 23 MRFTA to the Article 19 AML which prevents UBPs. Some scholars also explain that Article 23 is adopted from the influence of section 5 of the US Federal Trade Commission (FTC) Act,<sup>89</sup> because Article 19 AML was modelled on section 5, US FTC Act.<sup>90</sup> Wherever these provisions have models from, Articles 3-2 and 23 enforcements, like the AML enforcement problem in Japan, are quite confusing to competition lawyers and economists, because of overlap where investigating vertical restraints; furthermore, the KFTC's heavy reliance on Article 23 (or UBP) enforcement.<sup>91</sup> However, stricter obligations

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<sup>85</sup> The Constitutional Court of Korea deals with only the matters regarding the Constitution. Usually, the Supreme Court judgments cover the MRFTA cases.

<sup>86</sup> See Mitsuo Matsushita, *Introduction to Japanese Antimonopoly Law*, Yuhikaki Publishing, Tokyo, 1990, p. 3; Akira Inoue, *Japanese Antitrust Law Manual: Law, Cases, and Interpretation of Japanese Antimonopoly Law*, Kluwer Law International, Alphen aan den Rijn, The Netherlands, 2007, p. 1. The original AML was modelled after US antitrust law, contained several unique features when compared with current legislation. However, the MRFTA is more similar to the current structure of the AML.

<sup>87</sup> See Toshiaki Takigawa, 'Prospect of Antitrust Law and Policy in 21st Century: In Reference to Japanese Antimonopoly Law and Fair Trade Commission' *Journal of Korean Competition Law*, Vol. 8, 2002, pp. 171-2; Masako Wakui, *Supra.*, note 43, p. 95.

<sup>88</sup> However, some Korean scholars argue that the form of Art. 3-2 was borrowed from the German GWB. See, Jungwon Song, *Ca-Ru-Tel-Mit-Bul-Gong-Jung-Go-Rae-Haeng-Wui-Kyu-Jae [Regulations on Cartels and Unfair Business Practices]*, Parkyoungsa, Seoul, 2005, p. 486.

<sup>89</sup> Under the sec. 5 of the US FTC Act, unfair methods of competition in or affecting commerce are declared unlawful. This provision was legislated for a quick response of the US FTC to the anti-competitive practice that is not stated under the Sherman Act. Therefore, this legislative intent is somewhat different from Art. 23 MRFTA. See also Young-Dae Lee, *Supra.*, note 23, p. 249; Sigrid Stroux, *US and EC Oligopoly Control*, Kluwer Law International, The Hague, 2004, p. 67; Ho Yul Chung, *Kyoung-Jae-Bub [Competition Law]*, 2nd edn, Parkmunsa, Seoul, 2008, pp. 356-7.

<sup>90</sup> See Ho Young Lee, *Dok-Jum-Kyu-Jae-Bub-Ui-Ie-Ron-Kwa-Sil-Mu [Theories and Practices in Monopoly Regulation and Fair Trade Act]*, Hongmunsa, Seoul, 2006, pp. 208-9.

<sup>91</sup> *Supra.*, Figure 4.1 in Chapter 4.

and special responsibilities should be imposed on dominant firms to abide by competition rules,<sup>92</sup> and the necessity to broaden the applicable scope of Article 3-2. The status of special provision of Article 3-2 would provide sufficient legitimacy to this stringent approach, and the KFTC is supposed to apply this, rather than both Articles 3-2 and 23, to a case, as some Korean scholars have discussed.<sup>93</sup>

The current applications of Articles 3-2 and 23 in vertical cases is problematic, since these can still overlap each other,<sup>94</sup> and there is no clear guidance of application in order to distinguish between these two. The KFTC thus has a choice of application of provisions. In practice, it seems to apply Article 3-2 to *Chaebols* or near-*Chaebols*,<sup>95</sup> and Article 23 to smaller business groups, regardless of market share. This means that the KFTC applies Article 23 more than Article 3-2, where it is easier for it to catch a violation. In the refusal to deal cases, *Korea Electricity Corp.*,<sup>96</sup> *DuPont Korea*,<sup>97</sup> and *Hite Co.*,<sup>98</sup> the KFTC did not apply Article 3-2, but Article 23, although these firms had dominant positions under Article 4 (83, 100, 80, and 88.9 per cent respectively). The KFTC should have regarded these cases as Article 3-2 violations.

Vertical restraints can be treated either harshly as abusive conducts under Article 3-2, or leniently, as UBPs under Article 23. This implementation of law may cause confusion in its provisions. Some Korean commentators argue that to solve this problem the KFTC should reduce the threshold of application of Article 23 to SMEs, through establishing clear guidance to distinguish the application of the two provisions.<sup>99</sup> This provision seems to be

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<sup>92</sup> This seems the influence of the EC law, imposing strict limitations on the behaviours of dominant firms. See Vassilis Hatzopoulos, 'The EC Essential Facilities Doctrine' in Giuliano Amato and Claus-Dieter Ehlermann (eds), *EC Competition Law: A Critical Assessment*, Hart Publishing, Oxford, 2007, pp. 371-2.

<sup>93</sup> See Bong Eui Lee, 'Prohibition of Abuse of Market-Dominant Undertakings under the Monopoly Regulation and Fair Trade Act', *Journal of Korean Law*, Vol. 4, No. 2, 2005, p. 76.

<sup>94</sup> Ho Yul Chung, *Supra.*, note 89, pp. 354-5. The author argues there are problems of overlapping in its application of law in practice because the authority structures them as merely 'special' and 'general' provisions.

<sup>95</sup> E.g., *POSCO Co.*, KFTC Decision 2001-068, 2001*Kyoungchok*0389, Apr. 12, 2001; *Microsoft Co.*, KFTC Decision 2006-042, 2002*Kyoungchok*0452 and 2005*Kyoungchok*0375, Feb. 24, 2006; *Hyundai Motors*, KFTC Decision 2007-281, 2006*Dokgam*0746, May 18, 2007; *Intel Corp.*, *Intel Semiconductor Ltd.*, and *Intel Korea*, KFTC Decision 2008-295, 2007*Dokgam*1790 and 2008*Sijang*1126, Nov. 5, 2008.

<sup>96</sup> *Korea Electricity Corp.*, KFTC Decision 2001-043, 2001*Dokjom*0265, Mar. 31, 2001.

<sup>97</sup> *DuPont Korea*, KFTC Decision 2002-363, 2002*Kyoungchok*0588, Dec. 23, 2002.

<sup>98</sup> *Pusan and Kyoungnam Liquor Associations*, *Hite Co.*, and *Daesun Distilling Co.*, KFTC Decision 2004-238, 2004*Busa*0093, 2004*Busa*1025-27, July 31, 2004.

<sup>99</sup> See Jae-Hyoung Lee, 'Restrictions on Abuse of Market Dominant Position' in So-Mi Sung and Kwangshik Shin (eds), *Reviews on Amendment to the Korean Competition Law*, Korea Development Institute, Seoul, 2003, pp. 144-7; Jin-Kook Kim, 'Reviews on the Current Provision of Abuse of Market Dominant Position' in Seung-

very convenient for the KFTC, and this enforcement should be criticised as lazy. The KFTC has been blamed for excessive application of Article 23. The Article 23 enforcement should be clarified by narrowing the scope of Article 23. As stated, the JFTC seems to have the same trouble. For example, in the *Oita Diary* case,<sup>100</sup> the JFTC applied the UBP provision, rather than monopolisation, despite the enterprise's high market share, about 70 per cent. It is proven that this legislation structure in Korea and Japan causes confusion to the economic entities, who are accustomed to the regulatory systems in other competition regimes, which have clearer distinctions in enforcement.

#### 5.5.2.2. Origin of Double Standards: Special Provision and General Provision

Enterprises in the Korean market should rely on vertical restraint enforcement, which should have a clear-cut between Articles 3-2 and 23. Some scholars argue that there is a clear difference between these two provisions based on the fact that Article 23 is based on an *ex ante* approach,<sup>101</sup> but Article 3-2 is regarded as *ex post* provision.<sup>102</sup> They argue that the wordings, '*Teuk-Byol-Kyu-Jung*' (special provision) and '*Il-Ban-Kyu-Jung*' (general provision) distinguish the application of the two.<sup>103</sup> Article 3-2 is applicable only to enterprises with market dominance. Therefore, as a special provision, Article 3-2 is legislated to prevent market dominance. On the contrary, Article 23 applies to all enterprises, including those which are market dominant in the Korean market. Article 23 is therefore named as a general provision, because it can be generally applicable to any enterprise. Hence, there is a possibility that an enterprise with market power may infringe both Articles 3-2 and 23. There is no clear distinction between them despite the terms of special and general provisions. Another problem through unclear guidance leads to penalty incentives. The fine for Article 3-2 violation is a maximum three per cent of yearly turnover, which is more than Article 23's two per cent of turnover. Furthermore, the jail term for violation of Article 3-2 is three years,

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Hee Jwa, *Thoughts of Amendment of the Monopoly Regulation and Fair Trade Act*, Korea Economy Research Institute, 2004, pp.102-6; Young-Chul Lim, *Gong-Jung-Go-Rae-Bub [Korean Competition law]*, Bubmunsa, Seoul, 2007, pp. 35-42; Ho Yul Chung, *Supra.*, note 89, pp. 106-12.

<sup>100</sup> *Oita Diary*, JFTC Decision, July 7, 1981, *Shinketushu* 28-56. For further detail, see Masako Wakui, *Supra.*, note 43, p. 151.

<sup>101</sup> E.g., sec. III.1.A.(4) of the UBP Guidelines.

<sup>102</sup> Jungwon Song, *Supra.*, note 88, p. 485.

<sup>103</sup> *Ibid.*, p. 486; Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, p. 204.

and that for Article 23 two years,<sup>104</sup> and both a jail term and fines may be imposed concurrently for Article 3-2 violation.<sup>105</sup>

Because of these different measures of penalties, market dominant enterprises would have the incentive to be scrutinised under Article 23, rather than falling within the scope of Article 3-2, if there is no way to receive exemption. Despite these different penalties, the KFTC has not clearly demonstrated guidance. The argument of distinction between these two, as argued by some Korean scholars, is theoretical. They argue, where an enterprise infringes both provisions, Article 3-2 is foremost, because Article 3-2 is specially legislated in order to prevent market concentration in Korea. However, the KFTC opens a possibility of applying both provisions to one case in practice, as shown in *Microsoft*.<sup>106</sup> The KFTC concluded that *Microsoft* infringed Article 3-2 by coercing consumers to buy products by abusing its dominant position in the Windows PC system market, and restricted consumers' choice in having a better quality product. The KFTC also condemned its inhibiting competition by tying and driving out its rivals from the market by establishing entry barriers, which was violation of Article 23. This decision was unique to this case.<sup>107</sup> In conclusion, this ambiguous enforcement can be used as a discriminatory and unfair measure against large firms. Despite this problem, it is yet very unclear what the criteria should be to distinguish the applications of these, because of no relevant case law. Since *Microsoft* dropped its appeal in 2007,<sup>108</sup> it is difficult to know the courts' interpretations of the KFTC's double imposition.

#### 5.5.2.3. Presumption of Market Dominance: Unclear Statement Creates Uncertainty

The first troublesome question in vertical cases is to find the most proper relevant market and market dominance. This is essential to examine whether or not vertical restraint harms competition. To infringe Article 3-2, an enterprise should be first presumed as a market dominant enterprise. The MRFTA states that an enterprise shall be presumed as market

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<sup>104</sup> In order to impose jail term, the KFTC needs to prove not only effects of the business practice but also intention. See Sang-Yong Park and Ki-Sup Um, *Kyoung-Jae-Bub-Wol-Lon [The Principle of Economic Law]*, 2nd edn, Parkyoungsa, Seoul, 2006, p. 89.

<sup>105</sup> Arts. 66 and 67 MRFTA.

<sup>106</sup> *Microsoft Co.*, KFTC Decision 2006-042, 2002Kyoungchok0452 and 2005Kyoungchok0375, Feb. 24, 2006.

<sup>107</sup> E.g., *Microsoft* (COMP/C-3/37.792), 24 Mar. 2004. *Microsoft* infringed Art. 82 EC only on the ground of ties by abuse of dominant position.

<sup>108</sup> *Microsoft* submitted a letter for the withdrawal of the legal suit, and the KFTC settled this by agreeing to it. See KFTC, *Newsletter*, Issue 4, Oct. 31, 2007, p. 10: [http://eng.ftc.go.kr/bbs.do?command=getList&type\\_cd=10](http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=10) (accessed 11 March 2009).

dominant where (i) market share of one enterprise is 50 per cent or more under Article 4(1); or (ii) total market share of three enterprises is 75 per cent or more under Article 4(2). However, those whose market share is less than 10 per cent shall be excluded under the *de minimis* rule.<sup>109</sup> In addition to this Concentration Ratio (CR) test, according to section III of the Market Dominance Guidelines,<sup>110</sup> the KFTC considers the following factors to decide market dominance: (i) entry barriers; (ii) rivals' market power; (iii) possibility of collusion; (iv) substitutability of goods and services; (v) market foreclosure; (vi) financial strength; and (vii) other considerations such as possibility of changing trading partners. However, it seems that the KFTC heavily relies on CR provision for presumption in the test of market dominance.

To illustrate an example regarding market share consideration of this CR test, presume there are five enterprises whose market shares in a certain market are respectively, A: 45 per cent; B: 25 per cent; C: 16 per cent; D: 9 per cent; and E: 5 per cent. In this case, Article 4(1) cannot be applied, since there is no enterprise with market share over 50 per cent. Then, only Article 4(2) is applicable. Because the total market share of A, B, and C is 76 per cent, these enterprises are presumed market dominant. However, because D and E's market shares are less than 10 per cent, they will not be presumed market dominant.<sup>111</sup> This presumption of market dominance is not very practical to effectively prevent abuse of market dominance, nor improve efficiency by vertical restraints. For instance, enterprises B and C can be blamed for Article 3-2 violation, despite their small market shares, 25 and 16 per cent, which are not very influential in the market. This problem can be observed in several cases. The recent cases, *Hyundai Motors*<sup>112</sup> and *Interpark*,<sup>113</sup> show that even less than 40 per cent of market share can be presumed as market dominant. In *Hyundai*, the total market share of the top three firms was 78.8 per cent as, *Hyundai Motors*, 44 per cent, *Kia Motors*, 22.6 per cent and *Renault-Samsung Motors*, 12.2 per cent. Although *Hyundai's* market share was less than 50 per cent, it was considered market dominant. In *Interpark*, the firm's market share was 39.5 per cent, and it was the second largest in the relevant market. However, the KFTC

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<sup>109</sup> This market share should include the affiliates' share and if it is over 10 per cent, *de minimis* rule will not be applicable. For further explanation, see Sang-Yong Park and Ki-Sup Um, *Supra.*, note 104, p. 73.

<sup>110</sup> Notification No. 2002-6 of the KFTC, May 16, 2002.

<sup>111</sup> Sang-Yong Park and Ki-Sup Um, *Supra.*, note 104, p. 72. The author illustrates a similar case.

<sup>112</sup> *Hyundai Motors*, KFTC Decision 2007-281, 2006Dokgam0746, May 18, 2007.

<sup>113</sup> *Interpark G Market Corp.*, KFTC Decision 2007-555, 2006Sukyoung4846, Dec. 18, 2007. Some Korean scholars explain that even in an agreement case, when a firm has a 40-50 per cent market share, the KFTC often considers it has a market dominant position. See also Jungwon Song, *Supra.*, note 88, p. 97.



considered this market share sufficient to be presumed as market dominant, regardless of other aspects of easy market entry in the internet shopping market.

The Market Dominance Guidelines provide diverse methods to examine market dominance. However, since the market share guidance is the most important one to decide market dominance presumption, the supplementary criteria are not very helpful. The KFTC heavily relies on the CR test.<sup>114</sup> There is no doubt that market share of an enterprise is a milestone to examine its market dominance, which a competition authority usually relies on. Although the market share test is the foremost criterion for presumption of market dominance, the KFTC has not established a clear statement of a threshold as a specific market share. This unclear market dominance test generates uncertainty in implementation. To estimate the margin from trade-offs between pro- and anti-competitive effects by vertical restraints, a market share threshold test is crucial for granting legal certainty.<sup>115</sup> This test guarantees efficient and pro-competitive business activities by enterprises that are engaging in vertical arrangements. Besides, a substantive market share test is suitable for Korean competition law and its civil law tradition. Otherwise, the degree of uncertainty associated with the current presumption in the test of market dominance in question may increase.

### 5.5.3. Implementation of UBP Guidelines in Theory and Practice

Some economists' view of an enterprise as an efficiency instrument demonstrates that enterprises seek to monopolise markets, sometimes by engaging in strategic behaviour, or by pursuing their own goals.<sup>116</sup> However, there are conflicting economic theories in competition policies regarding this problem. Where an enterprise has dominant market power, competition law is more complicated than a simple explanation of enterprises as efficiency instruments, such as issues of the duty to cooperate with rivals. The doctrinal question is raised when such an enterprise's unilateral practice is illegal.<sup>117</sup> Because of the fundamentally

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<sup>114</sup> This practice can be also seen in the UBP cases, e.g., *Bohae Distrilling Co.*, KFTC Decision 98-125, June 29, 1998; *POSTEEL and POSCO*, KFTC Decision 98-272, Nov. 25, 1998.

<sup>115</sup> However, some scholars do not agree with this legal certainty justification. See Roger Van den Bergh, 'The Difficult Reception of Economic Analysis in European Competition Law' in Antonio Cucinotta, Roberto Pardolesi and Roger Van den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, pp. 46-50.

<sup>116</sup> Oliver Williamson, (*Economic Organization*), *Supra.*, note 18, p. 163.

<sup>117</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 49, p. 367. The underlying policy issue here is to what extent competition law should restrict rights to exclude.

different conceptual approaches of the Harvard and Chicago schools, some argue that economic theory has contributed relatively little to the development of corresponding legal doctrine.<sup>118</sup> Nevertheless, it is obvious that this conflict does not create confusion, but a better understanding of vertical restraints. The KFTC should take into account the balance of costs and benefits to enterprises, based on the disciplines of these economic schools. However, the most important doctrine in its enforcement should be to take an *Anti-trust* policy rather than an *Anti-Chaebol* policy that would possibly hamper the growth of large firms whose greater efficiency threatened the SMEs.<sup>119</sup>

Of course, a failure to do anything about *Chaebols* has raised, and will continue to raise, serious problems.<sup>120</sup> In theory, the state can regulate economic affairs in the market to maintain balanced growth and stability of the economy, and to prevent abuse of market power.<sup>121</sup> Therefore, it is essential for the KFTC to set up a net to catch unscrupulous big fish. Otherwise, it will hamper competition, as well as economic growth by efficiency-seeking enterprises, working as the means of efficiency instruments. The KFTC should establish a creative rule of what size of net is necessary for efficiency-enhancing enterprises. To sum up, the KFTC should be equipped with sound vertical guidelines to prevent exercise of monopolistic and oligopolistic power, as well as improve efficiency from the nature of enterprises. The KFTC therefore has to regard efficiency justification of vertical restraints as one of the important objectives in competition law. Although the KFTC has provided the UBP Guidelines by seeking to enhance inter-brand competition,<sup>122</sup> it has not clearly stated the degree of tolerance. Therefore, the KFTC should provide new guidelines to include the method of market share threshold test of safe harbour for legal certainty. The UBP Guidelines already provide a safety zone, but the market share threshold is as low as 10 per cent, which cannot guarantee a sufficient degree of efficiency.

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<sup>118</sup> See George Hay, 'Oligopoly, Shared Monopoly, and Antitrust Law', *Cornell Law Review*, Vol. 67, 1982, p. 440.

<sup>119</sup> See George Stigler, 'The Origin of the Sherman Act', *The Journal of Legal Studies*, Vol. 14, No. 1, 1985, p. 4.

<sup>120</sup> Some scholars argue that competition law should do something on large firms to prevent externalities from market concentration. See Donald Turner, 'The Scope of Antitrust and Other Economic Regulatory Policies', *Harvard Law Review*, Vol. 82, No. 6, 1969, p. 1212.

<sup>121</sup> Art. 119(2) Constitution of Korea.

<sup>122</sup> E.g., sec.V.7.A.(2)(C) of the UBP Guidelines.

The KFTC does not have a broad concept of regulations or guidelines that are only provided for vertical restraints. This is because Article 23 MRFTA covers vertical restraints. Unlike other competition regimes, Article 19 MRFTA covers only horizontal agreements. The US antitrust law provides section 1 of the Sherman Act, which prohibits anti-competitive agreements, and section 2 of the Sherman Act, which prevents monopolisation and attempts to monopolise. EC competition law also has the provisions of Articles 81 and 82 EC and *vice versa*. In these competition regimes, regulations on anti-competitive agreements include both horizontal and vertical. In Japan, the second half paragraph in Article 3 AML used to cover only horizontal agreements, but currently the application of law seems to be applicable to vertical cases. Nevertheless, Korean competition law does not have this distinction. Article 23 and the UBP Guidelines seem supplementary to Article 3-2 in vertical cases. If the KFTC provides vertical guidelines along with the amendment to Article 19 enforcement in order to cover all sorts of arrangements, it will ensure pro-competitive practices by the means of clearer guidance to lawyers and enterprises. In particular, the Korean market is becoming international, and therefore the KFTC must provide a globally understood vertical regulation that may not be discriminatory against domestic or foreign enterprises, and also give clear guidance. Although existing UBP Guidelines state various aspects also including efficiency justification, the Guidelines do not include the efficiency rationale, such as reduction of transaction costs, which is crucial for improvement of the global aspect. The KFTC needs to set a clear statement of efficiency justification and special responsibility of market dominant firms in vertical guidelines.

#### 5.5.4. Justifications for Inter-brand Competition in RPM: Per Se or Rule of Reason?

As stated in Chapter 3, vertical restraints enhance efficiency and competition between brands, especially through restricting intra-brand competition as a method to solve the free-riding problem. However, there is a clear difficulty of distinguishing between the pro- and anti-competitive explanations in particular cases when the market is concentrated. Korean competition policy has been often hostile to vertical restraints, despite their possible benefits, for this reason. Vertical restraints involving minimum RPM, thus, continue to be per se unlawful under Article 29 MRFTA, although a rule of reason approach is followed for vertical non-price restraints, under Article 23. Economic analysis supports this step in respect of vertical non-price restraints on intra-brand competition, and would justify a similar

approach for vertical restraints involving price, where the RPM is maximum or recommended.<sup>123</sup> Free-riding retailers allow quality to deteriorate and ruin product reputation.<sup>124</sup> Suppliers, therefore, have an incentive to extend their reach to include constraints on the condition of distribution.<sup>125</sup>

This quality rationale of free-riding justification could have been discussed in quite a number of RPM violation cases in the Korean cosmetics market, such as *LG Health Corp.*,<sup>126</sup> *L'Oreal Korea*,<sup>127</sup> *Aekyoung Cosmetics*,<sup>128</sup> *Koreana Cosmetics*,<sup>129</sup> *Hankuk Cosmetics*,<sup>130</sup> *Namyang Aloe Corp.*,<sup>131</sup> and *Amore Pacific Corp.*<sup>132</sup> This could also be observed in luxury import products that need pre-sale services such as *Samsonite Korea*,<sup>133</sup> *Mercedes Benz Korea*,<sup>134</sup> and *Audi Volkswagen Korea*.<sup>135</sup> The brand image justification is well recognised in other regimes. For example, brand and quality rationale in the cosmetics industry was granted by the Supreme Court of Japan. In *Shiseido*,<sup>136</sup> the Supreme Court of Japan held that the firm's restriction of sales methods was reasonable, since it attempted to satisfy customers by providing its consultation service, and maintaining its distinguished reputation.<sup>137</sup> In particular, an effective sales and marketing effort by a retailer does not involve simply being competitive on price with other distributors, but should help develop and enhance the product's reputation, such as image, that is crucial for both *ex post* and *ex ante* sales. Sometimes, vertical restraints should be understood as an important component of a supplier's marketing strategy for inducing its products.<sup>138</sup>

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<sup>123</sup> John Vickers and Donald Hay, *Supra.*, note 21, pp. 7-8.

<sup>124</sup> This quality assurance was confirmed in the franchise case, *BBQ Chicken Corp. v. KFTC*, Supreme Court 2003Du7484, July 9, 2005. For further case discussion, see also Hae-Shik Park, 'Limits on Franchisor's Control in Franchisee' *Journal of Korean Competition Law*, Vol. 12, Aug. 2005, p. 351.

<sup>125</sup> Oliver Williamson, (*Economic Organization*) *Supra.*, note 18, p. 184.

<sup>126</sup> *LG Health Corp.*, KFTC Decision 2002-367, 2002Danchae1696, Dec. 24, 2002.

<sup>127</sup> *L'Oreal Korea*, KFTC Decision 2002-368, 2002Danchae1700, Dec. 24, 2002.

<sup>128</sup> *Aekyoung Cosmetics*, KFTC Decision 2003-002, 2002Danchae1699, Jan. 6, 2003.

<sup>129</sup> *Koreana Cosmetics*, KFTC Decision 2003-003, 2002Danchae1697, Jan. 6, 2003.

<sup>130</sup> *Hankuk Cosmetics*, KFTC Decision 2003-004, 2002Danchae1698, Jan. 6, 2003.

<sup>131</sup> *Namyang Aloe Corp.*, KFTC Decision 2005-184, 2005Teukbo0532, Sept. 26, 2005.

<sup>132</sup> *Amore Pacific Corp.*, KFTC Decision 2006-269, 2006Sokyoung0387, Nov. 28, 2006.

<sup>133</sup> *Samsonite Korea Corp.*, KFTC Decision 2002-213, 2002Yugo1369, Dec. 23, 2002.

<sup>134</sup> *Mercedes Benz Korea Corp.*, KFTC Decision 2007-164, 2006Sokyoung2420, July 6, 2007.

<sup>135</sup> *Audi Volkswagen Korea Corp.*, KFTC Decision 2008-477, 2008Kigan2004, Oct. 31, 2008.

<sup>136</sup> *Shiseido Co., Ltd.*, Supreme Court of Japan, Dec. 14, 1998, *Saiko Saibansho Minji Hanreishu (Minshu)* 52-9-1866. However, this case was not an RPM case but restriction on sales method.

<sup>137</sup> For detail, see Masako Wakui, *Supra.*, note 43, pp. 166-7.

<sup>138</sup> See David Scheffman, 'Antitrust, Economics, and "Reality"' in Malcolm Coate and Andrew Kleit (eds), *The Economics of the Antitrust Process*, Kluwer Academic Publishers, Norwell MA, USA, 1996, p. 241-2.

This rationale has not, however, been discussed in Korea because minimum RPM was a per se violation, even when some product markets were very competitive. Following the efficiency defence of free-riding and welfare gains,<sup>139</sup> it is necessary to justify inter- and intra-brand distinction. Since the implication of extending justifications is in the direction of increased permissibility worldwide, it may be appropriate to RPM to hold that inter-brand violations should be illegal, whilst intra-brand restraints are presumptively legal. A potential justification for the inter- and intra-brand distinction is that plausibility of the efficiency arguments may be weaker by inter-brand restraints. This may be rational, relative to the higher potential costs of eliminating competition, because the externalities regarding point-of-sale service, quality certification, and advertising would be less likely in inter-brand competition.<sup>140</sup> Moreover, little empirical evidence is available to support a per se rule, even in vertical price restraints, when efficiency is adopted as the criterion.<sup>141</sup> Although there could be some empirical evidence supporting the per se rule, this may not be easy for judges to apply.<sup>142</sup> Therefore, the KFTC should regard RPM as one of the major justifications for vertical cases.

## 5.6. Concluding Remarks

The study of vertical cases has presented difficulties at both theoretical and policy levels of analysis. Vertical restraints are the response to expensive practices that are present under certain types of transaction, in other words, in order to reduce transaction costs. If the costs of operating competitive markets are zero, there is no reason to have vertical restraints such as exclusive dealing, which is often condemned under Article 3-2 or 23 MRFTA. Competition policy interest in vertical restraints has been concerned mainly with the possibility that these can be used strategically to achieve benefits from anti-competitive effects.<sup>143</sup> Although an

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<sup>139</sup> See Howard Marvel and Stephen McCafferty, 'The Welfare Effects of Resale Price Maintenance', *Journal of Law and Economics*, Vol. 28, No. 2, 1985, p. 371.

<sup>140</sup> See Timothy Brennan, "'Vertical' Excuses for Horizontal Practices: Should There be Any Per Se Antitrust Rule?", *The Antitrust Bulletin*, Vol. 45, No. 2, 2000, pp. 484-5.

<sup>141</sup> See Peter Zweifel and Roger Zäch, 'Vertical Restraints: The Case of Multinationals', *The Antitrust Bulletin*, Vol. 48, No. 1, Spring 2003, p. 298.

<sup>142</sup> See Richard Posner, 'The Next Step in the Antitrust Treatment of Restrictive Distribution: Per Se Legality' *The University of Chicago Law Review*, Vol. 48, No. 1, 1981, p. 21.

<sup>143</sup> Oliver Williamson, (*Economic Organization*), *Supra.*, note 18, pp. 83-5.

enterprise is more than a simple efficiency instrument,<sup>144</sup> the KFTC should consider the effects of efficient practices on the market and national economy.

The contention in the next chapter is that the KFTC has much to learn from the US and the EC examples, rather than the Japanese. Their policies on vertical restraints have, in recent years, been much more willing to incorporate insights from economic analysis. These have fitted in well with the long history of US and EC legislation on the promotion of competition, in particular by the prevention of dominance, and by improving the efficiency rationale of vertical restraints.<sup>145</sup> Some can argue the competition policies in these regimes may not fit Korea, for their different legal systems, and also, different goals. However, if competition law contains economic as well as non-economic goals, it is legitimate for the KFTC to reassess the relative weights of the objectives of other competition laws, just as it is legitimate for the courts to reassess the application of economic principles. The US antitrust law does not stand still on economic principles. The US system may give more flexible efficiency justification benefits. On the contrary, competition law such as in the EC may give a better legal certainty than US law.<sup>146</sup>

Korea can get positive outcomes from both systems. Although the Korean legal tradition is not used to flexible application, many Korean scholars argue that the MRFTA implementation allows a rule of reason approach, especially in the UBP cases. In particular, the abundant numbers of UBP cases helped the KFTC and the courts develop the rule of reason.<sup>147</sup> Therefore, the KFTC can adopt both methods from common law and also civil law in its implementation of competition law, grounded on economics. In conclusion, the KFTC needs to learn from other competition regimes, but modify them to the Korean system. Vertical restraints in Korea have been mostly regarded as a means of market foreclosure. This presumption can impede both international trade and efficiency. Vertical restraints may enhance inter-brand competition and efficiency through vigorous competition, by improving trade. Moreover, vertical restraints may enhance the national economy through providing

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<sup>144</sup> *Ibid.*, p. 86.

<sup>145</sup> John Vickers and Donald Hay, *Supra.*, note 21, p. 47.

<sup>146</sup> Frank Easterbrook, *Supra.*, note 19, p. 138. The author describes the characteristics of the US common law.

<sup>147</sup> See Ho Yul Chung, 'Case Review on Restrictive Condition Practice of DPK International Corp.' in Korea Fair Trade Association, *Comparative Case Study of Competition Laws*, Parkyoungsa, Seoul, 2003, p. 207.

efficient distribution. Therefore, the KFTC should regard the evolution of distribution channels in the global market as reasonable practice.

## Chapter 6

# Modernisation of Korean Vertical Regulation: Proposals for New Legislation and Future Implications

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### 6.1. Creation of New Korean Type Vertical Regulation from Comparative Studies

Competition law is subject to development and change, because the world economy is dynamic, and economic theories progress and accumulate. In addition, social, political and philosophical thoughts about the economy also shift.<sup>1</sup> Learning from comparative studies will, in particular, help the Korean Fair Trade Commission (KFTC) keep up with these dynamic developments in globalised competition law and policy. Then, these issues should be considered with regard to whether foreign solutions are superior to the Korean system. First, it is necessary to acknowledge that existing systems in the foreign competition regimes are satisfactory in their origin. Second, it should be asked whether foreign approaches can work in the Korean competition regime. The differences in legal procedures, cultures and policies in various authorities can require some modifications when adopted in other countries' methods. Therefore, the KFTC should modify resolutions for the Korean system.<sup>2</sup>

Competition law in the Monopoly Regulation and Fair Trade Act (MRFTA) on vertical restraints (hereafter, vertical regulation) was critically analysed with reference to the US, the EC, and Japan in previous chapters. In particular, study of the US and EC provisions was necessary to provide the KFTC with a better idea of vertical regulation, in order to solve a problem which cannot be sorted out by its own system. As Korean competition law was significantly influenced by the Japanese Antimonopoly Law (AML), critical analysis of the existing provisions of market dominance and Unfair Business Practice (UBP) in Korea and

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<sup>1</sup> See Lawrence Sullivan and Warren Grimes, *The Law of Antitrust: An Integrated Handbook*, 2nd edn, Thomson West, St. Paul MINN, USA, 2006, p. 1.

<sup>2</sup> See Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law*, 3rd edn, Oxford University Press, Oxford, 1998, pp. 15-7.



Japan may give an improved design for vertical regulation reform. Some argue that vigorous competition has long been missing in Japan. Japanese culture has not traditionally embraced the idea of competition.<sup>3</sup> This situation was very similar to that in Korea at the beginning of the MRFTA legislation. However, current vigorous enforcement gives evidence that the KFTC is so active as to sometimes misapply the relevant law. This means that the historical development of the laws in Korea and Japan is dissimilar, through emphasis on *Chaebol* control. The excessive control on *Chaebols* by the law gives comparative disadvantages to *Chaebols* in the Korean market.

Therefore, considering overall problems such as efficiency and trade in the Korean market, a clear guidance for application of relevant provisions is essential. Accordingly, the KFTC has to amend the current legal provisions of market dominance and UBP, since the adopted provisions do not fit the Korean market. This chapter will critically argue that provisions influenced by the AML should be amended more closely to the US and the EC in vertical cases. Legal prohibitions are appropriate only when vertical restraints have clearly anti-competitive consequences, difficult to avoid because of high entry barriers. When entry barriers are high, market power can be inferred simply from a large market share with evidence that firms are not competing aggressively.<sup>4</sup> This entry barrier can be easily facilitated by market concentration. However, market concentration is one of the common features of economic development, and is not unique to Korea. Nevertheless, the treatment of *Chaebols'* market concentration has been different from other regimes, by dint of historical, cultural, and economic differences.<sup>5</sup>

Most areas of competition law are constantly evolving. Competition authorities in each country strive to improve legal standards of competition law. For this objective, mutual learning from other countries' practices is very important. The market economy functions in

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<sup>3</sup> See Harry First, 'Antitrust Enforcement in Japan', *Antitrust Law Journal*, Vol. 64, 1995, pp. 138-46; Douglas Rosenthal and Mitsuo Matsushita, 'Competition in Japan and the West: Can the Approaches Be Reconciled?' in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington, D.C., 1997, p. 314.

<sup>4</sup> See Frederic Scherer, 'Retail Distribution Channel Barriers to International Trade', *Antitrust Law Journal*, Vol. 67, 1999, p. 111; Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution*, Harvard University Press, Cambridge MA, USA and London, 2005, p. 102.

<sup>5</sup> See Myoungsu Hong, *Chaebol-Ui-Kyoung-Jae-Ryuck-Jib-Jung-Kyu-Jae [Regulations on Economic Concentrations of Chaebol]*, Kyoungin Publishing, Seoul, 2006, p. 3. The author explains that the market concentration problem in Korea is different from that in other regimes because of its different aspects based on historical or economic conditions.

the same way worldwide, so that competition law principles, especially of vertical restraints in most competition regimes, become increasingly alike.<sup>6</sup> The questions of reform of this aspect will be answered in the subchapters below, through suggestions of amendments to the MRFTA, learned from other competition regimes. The first step should be to create clear guidance of Article 3-2 MRFTA enforcement.

## 6.2. Amendment to Provisions of Abuse of Market Dominance

### 6.2.1. Amendment to Article 4 MRFTA and Market Dominance Guidelines

In vertical cases, the absence of market power is often the determining condition by the KFTC and other competition authorities.<sup>7</sup> The MRFTA views enterprises in monopolistic positions as market dominant, although in specific cases it is not easy to judge which enterprise occupies market power. Accordingly, in order to reduce this problem, the MRFTA takes market shares as a criterion, establishing a system deeming certain firms as market dominant under Article 4.<sup>8</sup> This presumption was provided to alleviate KFTC's burden of proof. However, there has been criticism of presumption in the test of market dominance, which has contributed to protect inefficient competitors.<sup>9</sup> The dominant concern is that vertical restraints without market power may have flexible application under competition law. In contrast, vertical restraint by an enterprise with significant market power will foreclose a sufficient share of the up- or downstream market in order to impede competition.<sup>10</sup>

The simplest solution would be to presume the legality of all vertical restraints based on market power. Then, the market share threshold test should be the centre of assessing

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<sup>6</sup> See Toshiaki Takigawa, 'Prospect of Antitrust Law and Policy in 21st Century: In Reference to Japanese Antimonopoly Law and Fair Trade Commission' *Journal of Korean Competition Law*, Vol. 8, 2002, p. 189.

<sup>7</sup> See Kevin Arquit, 'Market Power in Vertical Cases', *Antitrust Law Journal*, Vol. 60, 1992, p. 921; Massimo Motta, *Competition Policy: Theory and Practice*, Cambridge University Press, Cambridge, 2004, p. 343.

<sup>8</sup> See Ohseung Kwon, 'Retrospect and Prospect on Korean Antitrust Law', *Journal of Korean Law*, Vol. 4, No. 2, 2005, p. 5.

<sup>9</sup> See Bong Eui Lee, 'Prohibition of Abuse of Market-Dominant Undertakings under the Monopoly Regulation and Fair Trade Act', *Journal of Korean Law*, Vol. 4, No. 2, 2005, pp. 66-70.

<sup>10</sup> See Einer Elhauge and Damien Geradin, *Global Competition Law and Economics*, Hart Publishing, Oxford, 2007, p. 451.

market power, although sometimes it does not indicate a firm's actual market power.<sup>11</sup> Market share is used as the leading evidence worldwide for presumption in the test of market power, because it is a relatively simple measure.<sup>12</sup> It contains crucial information on the competitive strength of each of the market entities, and also the whole range of market structure.<sup>13</sup> Therefore, the test of dominance based on a certain standard of market share would eliminate ambiguity in litigation. The presumption of market dominance is also very important to distinguish Articles 3-2 and 23 MRFTA applications. The difference between concerted and unilateral action is irrelevant based on the definition of market dominant position, because horizontal concerted action is covered only by Article 19. Thus, a presumption in the test of market dominance held by a firm whose vertical restraint is not anti-competitive, enquires into the real pro-competitive effect on the market where vertical restraint is unilateral.

Therefore, market share should be the leading evidence to assess anti-competitive effects by vertical restraints, as stated above. Enterprises with less than 50 per cent market share should be presumed to have no significant market power.<sup>14</sup> However, current KFTC decisions such as *Interpark* and *Hyundai Motors* show that market share of less than 50 or even 40 per cent could be presumed market dominant, and could inhibit competition in vertical cases.<sup>15</sup> Most competition regimes usually do not have a statutory provision of market dominance presumption, according to a market share threshold test.<sup>16</sup> However, case law in the US and the EC also indicates concerns about assessing market power and dominance. The US Supreme Court has stated that market shares above 66 per cent indicate a

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<sup>11</sup> See Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, 3rd edn, Thomson West, St. Paul, MINN, USA, 2005, p. 128; Lawrence Sullivan and Warren Grimes, *Supra.*, note 1, p. 63.

<sup>12</sup> See George Shepherd, Joanna Shepherd, and William Shepherd, 'Antitrust and Market Dominance', *The Antitrust Bulletin*, Vol. 46, No. 4, 2001, p. 841.

<sup>13</sup> See Luc Peepkorn and Vincent Verouden, 'The Economics of Competition' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, Oxford University Press, Oxford, 2007, pp. 57-8.

<sup>14</sup> See Michal Gal, *Competition Policy for Small Market Economies*, Harvard University Press, Cambridge MA, USA and London, 2003, p. 65. The author suggests 50 per cent of market share presumption is adequate for small market economies.

<sup>15</sup> 44 per cent in *Hyundai Motors*, KFTC Decision 2007-281, 2006Dokgam0746, May 18, 2007; 39.5 per cent in *Interpark G Market Corp.*, KFTC Decision 2007-555, 2006Sukyoung4846, Dec. 18, 2007.

<sup>16</sup> The EC and the US competition regimes do not have a particular regulation for this. However, the JFTC imposes remedies to under the existence of a monopolistic situation based on Concentration Ratio (CR) test. For further details, see Einer Elhauge and Damien Geradin, *Supra.*, note 10, p. 236.

monopolistic position.<sup>17</sup> Lower courts also have generally required a market share of at least 50 per cent to constitute monopoly power.

In the EC, the European Court of Justice (ECJ) held in *Hoffman-La Roche*<sup>18</sup> that a highly important factor for the presumption of market dominance is the existence of very large market shares. In *Hoffman-La Roche*, the undertaking had approximately 75 per cent to 87 per cent of market share.<sup>19</sup> In *AKZO*,<sup>20</sup> the ECJ referred to the passage quoted in the *Hoffman-La Roche* case, and indicated that 50 per cent of market share could be considered as very large, and thus create a presumption of market dominance. Generally, therefore, 70 per cent of market share or above will almost certainly constitute a dominant position, and a share of 50-70 per cent will raise a presumption of dominance.<sup>21</sup> Moreover, according to the discussion paper, and also guidance on the EC Commission's enforcement priorities in applying Article 82 EC to exclusive abuses, as an example of current EC thought, it is likely that very high market shares indicate a dominant position. This would be the case where an undertaking holds 50 per cent or more of the market, provided that rivals hold a much smaller market share. Furthermore, if the undertaking's market share is below 40 per cent, its dominance is not likely.<sup>22</sup>

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<sup>17</sup> *United States v. E.I. du Pont de Nemours & Co.*, 351 US 76 S.Ct., 1264 (1956) at 379, observing that *du Pont* produced 75 per cent of the cellophane sold in the US and that the enterprise may be presumed to have monopoly power; *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 US 451, 112 S.Ct. 2072 (1992), at 481, holding that a 80-95 per cent market share is enough to survive a summary judgment, and describing a prior case as holding that over 2/3 of a market is a monopoly; *United States v. American Tobacco Co.*, 221 US 106, 31 S.Ct. 632 (1911), over 2/3 of the market and over 80 per cent of the field of comparable cigarettes constituted a substantial monopoly. See also Einer Elhauge, 'Defining Better Monopolization Standards', *Stanford Law Review*, Vol. 56, No. 2, 2003, p. 259; Keith Hylton, *Antitrust Law: Economic Theory and Common Law Evolution*, Cambridge University Press, Cambridge, 2003, p. 243; Andrew Gavil, 'Exclusionary Distribution Strategies By Dominant Firms: Striking A Better Balance', *Antitrust Law Journal*, Vol. 72, 2004, pp. 11-2; Robert O'Donoghue and Jorge Padilla, *The Law and Economics of Article 82 EC*, Hart Publishing, Oxford and Portland Oregon, USA, 2006, pp. 112-5; Einer Elhauge and Damien Geradin, *Supra.*, note 10, p. 245.

<sup>18</sup> Case 85/76, *Hoffman-La Roche & Co AG v Commission*, [1979] ECR 461, [1979] 3 CMLR 211.

<sup>19</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 10, p. 246.

<sup>20</sup> Case C-62/86, *AKZO Chemie BV v Commission*, [1991] ECR I-3359.

<sup>21</sup> E.g., Case 322/81 *NV Nederlandsche Baden-Industrie Michelin v. Commission* [1983] ECR 3461. In this case, market shares of 57 and 65 per cent were considered sufficient evidence of dominance. However, in *Virgin/British* OJ [2000] L30/1 [2000] 4 CMLR 999, less than 40 per cent was presumed as dominant. For more discussion about market share thresholds in other jurisdictions, see also Michal Gal, *Supra.* Note 14, p. 66; Carles Mosso, Steven Ryan, Svend Albaek, and Maria Centella, 'Article 82' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, 2007, Oxford University Press, Oxford, pp. 324-5; Mark Furse, *Competition Law of the EC and UK*, 6th edn, Oxford University Press, Oxford, 2008, pp. 292-4.

<sup>22</sup> Para. 31 of the DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (Dec 2005): <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf> (accessed 14 May 2009) and para. 14 of Guidance on the Commission's enforcement priorities in applying Article 82 of the

As seen in both regimes, less than 50 per cent of market share would not indicate market dominance, although other factors can be considered for the presumption of market dominance. Unlike the KFTC, both regimes do not necessarily show the total market share of a certain number of enterprises such as Concentration Ratio (CR) 3 in order to prove market dominance.<sup>23</sup> In particular, the EC guarantees block exemption for vertical agreements where a supplier's market share is less than 30 per cent.<sup>24</sup> These two regimes' approaches are successful to induce creative and efficient business activities at the vertical level, and also may give legal certainty<sup>25</sup> with the development of case law.<sup>26</sup> If a firm is unclear about the legal status of market dominance and the costs of investigating its market position are high,<sup>27</sup> a written provision of market share threshold gives more benefits. This rationale, especially in the EC, stems from the proposition that vertical agreements are detrimental to competition only where market power exists, and over-application of the law to vertical agreements is costly.<sup>28</sup>

The Korean competition system has not borrowed this idea of tolerance in vertical cases, and the KFTC condemns the market entities with some degree of market power at a vertical level, based on the assumption that they cannot be benign. Although the Korean market is a little more concentrated than large economies of developed countries, the KFTC can still apply the market dominance presumption in the US and EC as long as the domestic market is open to international competition. The existing provision of presumption under Article 4 MRFTA is almost equivalent to that in the AML. One of the 1977 amendments to the AML included a provision to control monopolistic conditions. This section, Article 2(7) AML, provides that in the event of a monopolised sector of the economy in which the market

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EC Treaty to abusive exclusionary conduct by dominant undertakings: [http://ec.europa.eu/competition/antitrust/art82/guidance\\_en.pdf](http://ec.europa.eu/competition/antitrust/art82/guidance_en.pdf) (accessed 14 May 2009).

<sup>23</sup> For further comparative study between the US and the EC, see also Giorgio Monti, *EC Competition Law*, Cambridge University Press, Cambridge, 2007, p. 143; Femi Alese, *Federal Antitrust and EC Competition Law Analysis*, Ashgate, Hampshire, UK and Burlington VT, USA, pp. 187-203.

<sup>24</sup> Art. 3 of EC vertical regulation.

<sup>25</sup> Some scholars however argue that the EC vertical regulation is not sufficient to give the benefit of legal certainty. See Romano Subiotto, 'The Reform of the European Competition Policy Concerning Vertical Restraints' *Antitrust Law Journal*, Vol. 69, 2001, p. 193.

<sup>26</sup> Ohseung Kwon, *Supra.*, note 8, p.12.

<sup>27</sup> See Michal Gal, 'Regulation by Declaration: A Novel Regulatory Mechanism to Limit Abuse of Monopoly Power', *NYU Journal of Law & Business*, Vol. 2, 2006, p. 422.

<sup>28</sup> See Richard Whish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' *Common Market Law Review*, Vol. 37, 2000, p. 907.

share of one (CR1) is 50 per cent or that of two enterprises combined (CR2) is 75 per cent or more, new entry into the relevant market would be difficult. The economic performance of the monopolising enterprises under this market structure is undesirable.<sup>29</sup> The Japanese provision is even more rational than the MRFTA, since the Japan Fair Trade Commission (JFTC) shows its concern about duopoly, and its CR2 test can work properly even in vertical cases. However, the Korean CR3 test can give an unclear imposition of burden to enterprises, which does not give legal certainty, as illustrated in the previous chapter. The KFTC's approach may create a risk of condemning an enterprise whose practices do not harm competition, where the enterprise has less than 50 per cent market share. Therefore, the KFTC should remove the presumption provision of CR3 method, although it can keep the rest of the presumption techniques.<sup>30</sup>

#### 6.2.2. Market Share Threshold and Other Criteria of Presumption Suggested

If vertical restraint and vertical merger had the same effects on the market regarding pro-competitive and anti-competitive aspects, the KFTC should treat them equally.<sup>31</sup> Vertical mergers that may result in market power have not been treated as objectionable per se in Korea, although vertical restraints with some degree of market power can infringe the law. Current cases such as *Interpark*<sup>32</sup> and *eBay/Interpark* merger,<sup>33</sup> evidence that the KFTC has not sufficiently established the criteria of market dominance presumption based on market share. In the former case, the KFTC held that *Interpark's* exclusive dealing was a violation of Article 3-2 MRFTA by concluding there was an entry barrier from its high market share. However, in the latter, it approved *eBay's* merger with *Interpark* with some remedies, and

<sup>29</sup> See Mitsuo Matsushita, *Introduction to Japanese Antimonopoly Law*, Yuhikaki Publishing, Tokyo, 1990, p. 5. The presumption of market dominance in the MRFTA could be also borrowed from the German GWB Art. 19(3) rather than the AML. GWB states that if 2 or 3 firms have a market share of 50 per cent or over, or 5 or less firms have a combined market share of 2/3 or over, they are assumed to be market dominant. For further explanation, see also Sigrid Stroux, *US and EC Oligopoly Control*, Kluwer Law International, The Hague, 2004, p. 19.

<sup>30</sup> See Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsa, Seoul, 2005, pp. 182-3. The author argues that Art. 4 should be amended such as the German GWB, Art. 19(3), CR3: 50 per cent or CR5: 66 per cent. However, this threshold is very low and may also disregard pro-competitive outcomes by vertical restraints.

<sup>31</sup> See Oliver Williamson, *Economic Organization: Firms, Markets, and Policy Control*, Harvester Wheatsheaf, Hertfordshire, 1986, p. 213.

<sup>32</sup> *Interpark G Market Corp.*, KFTC Decision 2007-555, 2006Sukyoung4846, Dec. 18, 2007.

<sup>33</sup> Preliminary merger decision, *eBay/Interpark*, KFTC Decision 2008Jisik2222, see also KFTC, *Newsletter*, Issue 9, Nov. 24, 2008: [http://eng.ftc.go.kr/bbs.do?command=getList&type\\_cd=10](http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=10) (accessed 11 March 2009).

stated that there would be low costs of market entry for its internet-based businesses. These two decisions illustrated the KFTC's different treatment of vertical restraint and merger.

The KFTC allows a vertical merger more easily than vertical restraints. Although the vertical restraint and merger have the same effects, the KFTC treats both differently. Nonetheless, there is no economic justification for a policy that treats vertical restraint and merger in a different way, using a per se rule of prohibition against, for instance, Resale Price Maintenance (RPM), whilst allowing all other restraints. In other words, it would be inconsistent to have a tough stance against some vertical restraints, whilst being lenient on vertical mergers.<sup>34</sup> Adopting a per se rule for vertical cases may thus result in negative effects, and the rule of reason should be applied in analysis of vertical cases.<sup>35</sup> The KFTC should therefore establish clearer guidance about criteria for vertical restraint investigation. It should regard the problem of effects in vertical cases when it measures market dominance. It should set a plausible presumption to induce a tolerant regulatory measure of vertical restraints, equal to vertical mergers. This will also help the rule of reason development in the case law.

When examining abuse of dominance in horizontal cases, the presumption of market dominance should be positioned more strictly than vertical cases. It can be reasonable for the KFTC to condemn an enterprise's practice with between 30 and 50 per cent of market share in horizontal or unilateral cases, considering other factors of market dominance. The KFTC can then prevent horizontal and anti-competitive abusive conducts, and tolerate vertical and pro-competitive practices. Thus, the KFTC should design new guidelines for abuse of market dominance, stating a special clause of tolerance for vertical cases. It should provide a legal measure with an instruction that market share of between 30 and 50 per cent in vertical cases may not create a presumption of abuse of market dominance. There would, however, be some problems if the KFTC adopted market share analysis as the only indicator to assess market power. It should take into account other factors to measure market power, since competitors in a market do not give always a sufficient signal of market power. Most of the *Chaebol's* affiliates are vertically integrated with financial power, and a *Chaebol* brand with lock-in effects may create significant monopoly power. This means merely relying on a market share test may fail to assess market power. Therefore, some other factors should be added to a

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<sup>34</sup> Massimo Motta, *Supra.*, note 7, p. 377.

<sup>35</sup> See Andy Chen and Keith Hylton, 'Procompetitive Theories of Vertical Control', *Hastings Law Journal*, Vol. 50, 1999, p. 621.

scrutiny of dominance presumption. Other indicators such as financial strength, number of competing suppliers, substitutability of products and entry barriers should be taken into account as supplementary tools of indication.<sup>36</sup>

There are, however, several reasons why a market share threshold test should be the major application, amongst other factors. First, vertical restraints can be harmful to competition, again only where the parties have significant market power. Second, although there are problems in assessing market power through a sound market definition, the methods of assessment and understanding of market definition have developed drastically. Third, a market share threshold provision can eliminate the regulatory burden from enterprises whose act would be efficient business conduct where it may be pro-competitive.<sup>37</sup> Therefore, other indicators can only support the market share threshold test, even if these criteria can be added to the new guidelines.

In conclusion, in order to establish presumption of market dominance under the MRFTA, the KFTC has to include five criteria in the test. First, an enterprise should have 50 per cent of market share in the relevant market, and second, enterprises with less than 10 per cent should get a *de minimis* exemption under Article 4 MRFTA. In addition, under Market Dominance Guidelines, the KFTC should indicate some factors to presume market dominance, in order to prevent anti-competitive effects by market power. To achieve this, the KFTC should tolerate the vertical restraints of enterprises with some market power in order to ensure an exemption for pro-competitive or efficient activities. This allows an enterprise with market share of between 30 and 50 per cent to have vertical practices by means of exemption from Article 3-2, although it still possibly violates Article 19 or 23. Fourth, the KFTC should designate that a supplier with market share of less than 30 per cent may get an automatic exemption from both Articles 3-2 and 19, where the practice is vertical. Finally, vertical restraint can infringe Article 3-2, where the practice has more than 50 per cent at either the horizontal or vertical level because it is likely to harm competition.

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<sup>36</sup> See Mark Griffiths, 'A Glorification of De Minimis – The Regulation on Vertical Agreements', *European Competition Law Review*, 2000, Vol. 21, No. 5, p. 245; Robert O'Donoghue and Jorge Padilla, *Supra.*, note 17, pp. 126-7. Financial strength can be seen as an indicator of dominance in the EC regime.

<sup>37</sup> See Simon Bishop and Derek Ridyard, 'EC Vertical Restraints Guidelines: Effects Based or Per Se Policy', *European Competition Law Review*, Vol. 23, No. 1, 2002, p. 35.



### 6.2.3. Presumption of Anti-Competitiveness or Unfairness: Economic Approach

The ultimate objective of Korean competition law seems to maintain a standard of business conduct which is considered fair. This goal would concern itself with judgments on how market power was used rather than with whether such power existed. However, the content of fairness is vague<sup>38</sup> when its identification with competitive market process is abandoned. In general, fairness embraces some concept of equal treatment of those in similar situations. Nevertheless, when a competitor becomes very successful or efficient, its rival can be willing to sue on the grounds that the competitive market process is unfair. Subsequently, every successful and efficient firm may expect a routine incident where it will be the defendant in competition law enforcement sooner or later on achieving a certain degree of market power. Vigorous competition seems, then, anti-competitive, and fair competition comes to mean no competition at all.<sup>39</sup> The word unfairness, in Article 3-2 and 23, can cover most business practices, and therefore catch conduct which is even pro-competitive. Some scholars argue that Korea should mainly focus on fairness through distribution or redistribution of wealth,<sup>40</sup> by protecting Small and Medium-sized Enterprises (SME) rather than freedom of competition. However, helping these firms cannot redistribute wealth.<sup>41</sup>

Many commentators assume Korea has a unique form of wealth concentration, due to the existence of *Chaebols*.<sup>42</sup> The social norms and values, however, always change as the national economy changes. In any event, therefore, the wealth redistribution argument for competition policy should not have any implications for the content of competition policy.<sup>43</sup> Unless there is a fairly general social agreement on the relevant classificatory variables, fairness tends to mean equal treatment for everybody. In practice, in the context of a market, this may mean equal treatment for firms operating in the market, rather than equal treatment

<sup>38</sup> Einer Elhauge, *Supra.*, note 17, p. 265. This is also problematic in the US monopolisation cases, e.g., *Spectrum Sports Inc. v. McQuillan*, 506 US 445 (1993).

<sup>39</sup> See William Baumol and Janusz Ordover, 'Use of Antitrust to Subvert Competition', *Journal of Law and Economics*, Vol. 28, No. 2, 1985, p. 525.

<sup>40</sup> For discussion about redistribution of wealth through competition policy, see Richard Whish, *Competition Law*, 6th edn, Oxford University Press, New York, 2009, p. 20.

<sup>41</sup> Myoungsu Hong, *Supra.*, note 5, pp. 254-7. For criticism against redistribution by competition law enforcement, see also Frank Easterbrook, 'Workable Antitrust Policy', *Michigan Law Review*, Vol. 84, No. 8, 1986, pp. 1703-4.

<sup>42</sup> See Joung-Woo Lee, 'Social Impact of the Crisis' in Duck-Koo Chung and Barry Eichengreen (eds), *The Korean Economy Beyond the Crisis*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2004, p. 148.

<sup>43</sup> See Richard Posner, *Antitrust Law*, 2nd edn, The University of Chicago Press, Chicago and London, 2001, p. 24.

for potential entrants. Forbidding the use of unfair tactics as a means of maintaining market power has been an important element in Korean competition law enforcement. For example, if a firm can coerce rivals, suppliers, or consumers, it is often assumed there is some force. Accordingly, this implies the acquiescence of the coerced party in a situation that is not the result of mutual free bargaining, so is unfair. Then, the meaning of unfairness is viewed as an aspect of market power. In many cases, an exercise of market power that distorts competition will implicate this fairness value which the Korean authority focuses on.<sup>44</sup>

Article 3-2 MRFTA prohibits unreasonable or unfair practices. However, its application is ambiguous, since the wording of unfairness does not necessarily mean anti-competitiveness, and is also vague as to economic models of voluntary exchange, despite its possible definition as unfair bargaining power perspective.<sup>45</sup> However, the KFTC and the courts have not indicated sufficient guidance for presumption in the scrutiny of unfairness. The Supreme Court simply stated that scrutiny whether the practice is unfair should be decided according to the possibility of impeding fair trade, after the overall review of various factors in a given situation, such as intention or objective.<sup>46</sup> In other words, it should weigh overall circumstances in deciding whether a vertical restraint should be prohibited. In refusal to deal cases under Article 23 such as *Coca-Cola*<sup>47</sup> and *SKC Co.*,<sup>48</sup> the Court also articulated unfairness as a major criterion of infringement scrutiny. However, the meaning of unfairness in Article 23 is different from that in Article 3-2. The concept of fairness under the MRFTA therefore has various meanings, which are confusing when applying Articles 3-2 and 23. It can signify similar treatment for firms in similar circumstances. The term can likewise be

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<sup>44</sup> For further discussion about fairness in market dominance enforcement, see Carl Kaysen and Donald Turner, 'Antitrust Policy: An Economic and Legal Analysis' in Thomas Sullivan (ed), *The Political Economy of the Sherman Act: The First One Hundred Years*, Oxford University Press, New York and Oxford, 1991, pp. 185-7; Lawrence Sullivan and Warren Grimes, *Supra.*, note 1, p. 25.

<sup>45</sup> See Benjamin Klein, 'Transaction Cost Determinants of "Unfair" Contractual Arrangements', *The American Economic Review*, Vol. 70, No. 2, 1980, P. 356.

<sup>46</sup> *Hyundai Information Technology Corp. v. KFTC*, Supreme Court 99Du4686, June 12, 2001.

<sup>47</sup> *Coca-Cola Co. v. KFTC*, Supreme Court 98Du17869, Jan. 5, 2001. This case has some similarity to the EC case, Joined Cases, 6/73 and 7/73, *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corporation v Commission* [1974] ECR 223, [1974] 1 CMLR 223, [1974] 1 CMLR 309 ECJ, 223n. However, the Korean judgment was very different. The Court did not accept *Coca-Cola's* anti-competitive and unfair intents since *Bumyang* continued its business after the refusal to supply. For further discussion about the EC and the US approaches, see also Alison Jones, 'A Dominant Firm's Duty To Deal: EC and US Antitrust Law Compared' in Philip Marsden (ed), *Handbook of Research in Trans-Atlantic Antitrust*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, pp. 236-86.

<sup>48</sup> *SKC Co., Ltd v. KFTC*, Supreme Court 2001Du1628, June 12, 2001. The Court held that there was no violation of Article 23 because the firm could purchase the relevant raw materials from others with a cheaper price.

considered as synonymous with fair play in the market, which can be interpreted as refraining from the use of bargaining position, and thus seeking to achieve reasonable profits rather than maximising. According to the views of fairness, it should be permissible to protect SMEs at the expense of society as a whole.<sup>49</sup>

This language must be distinguished from anti-competitiveness, and should be removed from Article 3-2.<sup>50</sup> This may furthermore confuse the meaning of fairness from Article 23. Article 23 also has this term as its purpose of protection of SMEs and consumers. The KFTC should apply Article 23 in a way similar to section 5 of the US Federal Trade Commission (FTC) Act. The vagueness of the term unfairness in the US act was limited by the 1994 amendment, which provides that the US FTC cannot deem conduct unfair unless the practice causes substantial injury to consumers. Although the US FTC can have authority to adopt substantive rules defining conduct it regards as unfair, it has not exercised this as a matter of practice.<sup>51</sup> However, current enforcement of Article 23 is notable for its over-application. Fair competition under Article 23 covers broader measures than that under Article 3-2, since Article 23 was legislated to protect consumers, competition, and even competitors.<sup>52</sup> Unfairness, itself, in both articles, can confuse the aims of the MRFTA, regardless of whether or not they have the same meaning.

The current controversy surrounding the application of law is not only confined to the difficulty of interpreting the meaning of unfair conduct, but also in practice. Along with the KFTC's guidelines, there have been some efforts of case law development regarding the subject of presumption of unfairness. All firms are generally free to deal with whom they wish, despite the duty to deal in some circumstances. This duty is controversial, because it interferes with the freedom of contract and basic property rights,<sup>53</sup> which are indispensable to

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<sup>49</sup> See Roger Van den Bergh and Peter Camesasca, *European Competition Law and Economics: A Comparative Perspective*, Intersentia, Antwerpen, Belgium, 2001, pp. 31-2.

<sup>50</sup> The wording in Art. 3-2 MRFTA may be the influence from Art. 82 EC. The origins of fairness language in Art. 82 EC are not entirely clear, but they most likely reflect the impact of the *Ordoliberalism* ideal on the initial drafting. Likewise, the Korean policy-makers may have added this based on the thoughts of *Ordoliberalism*. See also Robert O'Donoghue and Jorge Padilla, *Supra.*, note 17, p. 7.

<sup>51</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 10, p. 5.

<sup>52</sup> Ohseung Kwon, *Supra.*, note 30, p. 326.

<sup>53</sup> For further discussion by a comparative study of the US approach, see Rudolph Peritz, 'A Genealogy of Vertical Restraints Doctrine', *Hastings Law Journal*, Vol. 40, 1989, pp. 537-54.

a free market economy. It should therefore only be applied in extraordinary circumstances.<sup>54</sup> A current judgment in an Article 3-2 case showed the courts' development of freedom of business principles. The Supreme Court in *POSCO* reversed the judgment of the Seoul High Court, based on the fact that there was no unfairness.<sup>55</sup> *POSCO* did its best to cast doubt on the evidence accounts. It raised hints about fairness in business practice based on its intention test.

To raise this question and generate doubt, *POSCO* brought its defence based on its effects on the market. The *POSCO* case went further than previously in explaining why, under certain circumstances, *POSCO*'s competitor, *Hysco*, might get benefits from Article 3-2. The Court held that its refusal to deal was not unfair, because there was no actual negative impact on competition. There was no proof that *POSCO* intended to cause harmful effects on the market. *Hysco* could obtain the relevant products from other suppliers and get benefits from its business activity without *POSCO*'s supply. In this case, the Court examined whether there was an intention of market foreclosure as the means of unfairness, and concluded that a mere market share of 80 per cent, was not sufficient to blame for the conduct and therefore, the KFTC should not impose a duty to deal, since it could not explain why the practice was unfair.<sup>56</sup> However, it did not clearly consider the issue of objective justification in duty to deal, and whether unfairness can be narrowly defined as anti-competitiveness.

The Court merely focused on *ex post* standards for the challenge of strict legal measures against large enterprises. The counter-foreclosure concern against *Hysco*, which refused to supply, was not examined. If the KFTC and the Court had based its rationale on an appreciation of *POSCO*'s motives for implementing a restraint with an *ex ante* approach, it is likely that they would have drawn a better presumption of unfairness. The *POSCO* judgment is, however, still remarkable, since it brought out the real meaning of unfairness, based on justification from the lack of anti-competitive intention. Nevertheless, it would have taken a closer examination to show whether *Hysco* could have a market power of foreclosure through vertical integration against *POSCO*, by means of misusing the *ex post* standard by Article 3-2.

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<sup>54</sup> This is not the only problem in Korea but also in the EC. See Robert O'Donoghue and Jorge Padilla, *Supra.*, note 17, p. 405.

<sup>55</sup> *POSCO v. KFTC*, Supreme Court 2006Da5130, June 29, 2007.

<sup>56</sup> The Supreme Court of Korea seemed to discuss a limited application of essential facility doctrine concept illustrated by the *Areeda*. See Phillip Areeda, 'Essential Facilities: An Epithet in need of Limiting Principles', *Antitrust Law Journal*, Vol. 58, 1989, p. 853.

The courts should develop an *ex ante* yardstick in application of Article 3-2, especially in vertical cases. The reason is that the courts can almost never emphasise economic analysis of efficiency where they use an *ex post* measure. Therefore, economic analysis should be regarded as an important tool rather than the unfairness ideal, for the *ex ante* manner of Article 3-2 implementation.

There is no reason why the Korean competition regime cannot adopt exemption for efficiency improvements under Article 3-2 through more focus on economics, which will be different from EC competition law. Article 82 EC does not expressly foresee the possibility of exempting abusive behaviour because of efficiencies. However, there are some scholars seeking to find a way to include efficiencies in Article 82 EC, such as under Article 81 EC.<sup>57</sup> The Korean regime may avoid the problem of inconsistency with economics in Article 3-2 enforcement by providing clearer presumption of market dominance. Moreover, economic theories can be used to help guide the courts, the KFTC, and the policy-makers<sup>58</sup> to refine the concept of fairness in the MRFTA, which will be eventually evaluated as pro-competitiveness, based on the *ex ante* approach.

### 6.3. Amendment to Provision of UBP: Article 23 MRFTA and UBP Guidelines

#### 6.3.1. Articles 19 and 23 MRFTA: Single Provision for Agreement Cases

Competition regimes have distinctive legal provisions of (i) preventing an anti-competitive concerted act regardless of being a horizontal or vertical agreement; and (ii) preventing market dominance or monopolisation.<sup>59</sup> This measure can give a clear picture to enterprises and competition lawyers. Unlike other regimes, the Korean provision Article 19 MRFTA

<sup>57</sup> Robert O'Donoghue and Jorge Padilla, *Supra.*, note 17, p. 18; Neelie Kroes, 'Tackling Exclusionary Practices to Avoid Exploitation of Market Power: Some Preliminary Thoughts on the Policy Review of Article 82' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Competition Law 2006*, Juris Publishing, Huntington NY, USA, 2006, p. 390; Trevor Soames, 'Towards A "Smart" Article 82: Qui Audet Adipiscitur' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Competition Law 2006*, Juris Publishing, Huntington NY, USA, 2006, p. 465.

<sup>58</sup> See Thomas Jorde and David Teece, 'Innovation, Market Structure and Antitrust: Harmonizing Competition Policy in Regimes of Rapid Technological Change' in Leonard Waverman, William Comanor, and Akira Goto (eds), *Competition Policy in the Global Economy: Modelities For Competition*, Routledge, New York, 1997, p. 290.

<sup>59</sup> The US and the Japanese laws prohibit monopolisation but the MRFTA and the EC simply prevent abuse of market dominance.

prohibits only horizontal agreements which are unfair, and Article 23 can be applicable to both unilateral and collusive cases. This may confuse enterprises, especially foreign ones. In order to create Korean vertical regulation, the KFTC should provide a clear legal measure for vertical agreements under Article 19. Article 19, in fact, does not clearly state that it is only applied to horizontal agreements. Many Korean scholars have argued that Article 19, like its US and EC counterparts, should be applicable to vertical as well as horizontal agreements.<sup>60</sup> This Article 19 tradition of application for horizontal cases only was brought in from the traditional Japanese approach.

The JFTC prohibits anti-competitive concerted acts under the second half of Article 3 AML,<sup>61</sup> and vertical restraints under Article 19 AML. However, the Japanese courts have shown efforts to develop interpretations of Article 3 language similar to the US and the EC.<sup>62</sup> The Tokyo High Court in the 1953 *Asahi Newspaper* case<sup>63</sup> construed the term ‘concerted acts’ as used in the second half of Article 3 AML to only apply to horizontal agreements.<sup>64</sup> The Court denied the JFTC’s decision, based on the grounds that the firm had acted unilaterally, and there had been no mutual agreement between firms vertically. It interpreted the language in Article 3 AML narrowly, as only applicable to horizontal agreements. In *Toppan Mua K.K.*,<sup>65</sup> however, the Tokyo High Court constituted a rejection of the rationale which was adopted in the *Asahi Newspaper* judgment,<sup>66</sup> and found that enterprises which engaged in restricting the business activities of other firms do not have to be within the same level of distribution channel. Following this judgment, many argue that the agreement

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<sup>60</sup> See Ho Young Lee, ‘Su-Jik-Jok-Jae-Han-Go-Rae-Ui-Kyu-Jae’ in Ohseung Kwon (ed), *Gong-Jung-Go-Rae-Wa-Bub-Chi [Fair Trade and Regulation]*, Bubmunsa, Seoul, 2004, pp. 617-8.

<sup>61</sup> The language of Art. 2(6) AML (the definition of agreements), would not limit the Art. 3 application to vertical restraints. See John Haley, *Antitrust in Germany and Japan: The First Fifty Years, 1947-1998*, University of Washington Press, Seattle and London, 2001, p. 77; Akira Inoue, *Japanese Antitrust Law Manual: Law, Cases, and Interpretation of Japanese Antimonopoly Law*, Kluwer Law International, Alphen aan den Rijn, The Netherlands, 2007, pp. 9-12.

<sup>62</sup> See Mitsuo Matsushita, *International Trade and Competition Law in Japan*, Oxford University Press, Oxford, 1993, pp. 136-40; Jiro Tamura, ‘Market Access Issues in Japan’s Antimonopoly Law’ in Clifford Jones and Mitsuo Matsushita (eds), *Competition Policy in the Global Trading System*, Kluwer Law International, The Hague, 2002, p. 145.

<sup>63</sup> *K.K. Asahi Shinbun v. Kōsei Torihiki I'inkai*, 4 *Shinketsushū* 145, Tokyo High Court, March 9, 1953.

<sup>64</sup> For further discussion about this case, see Masako Wakui, *Antimonopoly Law: Competition Law and Policy in Japan*, Arima Publishing, Suffolk, 2008, pp. 57-8.

<sup>65</sup> *Toppan Mua K.K. v. JFTC*, Tokyo High Court, Dec. 14, 1993, 840 *Hanreitimes* 81.

<sup>66</sup> Mitsuo Matsushita, *Supra.*, note 29, pp. 38-40.

regulation of the AML covers both horizontal and vertical agreements, although this is not still completely settled in case law.<sup>67</sup>

This Japanese Court's interpretation seemed to be influenced by the EC approach taken in *Consten and Grundig*,<sup>68</sup> which confirmed that Article 81 EC could be applicable to vertical agreements. However, the KFTC and the courts have not fully considered this. The KFTC has, in practice, dealt with vertical restraints by the UBP provision, which provides a list of vertical restraints.<sup>69</sup> The KFTC should develop its implementation of Article 19 both in horizontal and vertical agreements, and should limit its implementation of Article 23 to unilateral cases. In order to achieve legal certainty of preventing anti-competitive vertical agreements, this amendment is critical. The KFTC can maintain Article 23 as a provision for preventing unfair and anti-competitive methods unilaterally, which can be observed in section 5 of the US FTC Act. The language in Article 23 can be general, but the enforcement should be more limited, such as the US FTC Act.<sup>70</sup> The number of Article 23 cases is overwhelming, despite its vague wording. The best way to implement Article 23, therefore, is to narrowly interpret its enforcement by limiting its scope to unilateral cases only.

### 6.3.2. Presumption of Efficiency in Vertical Restraints and Exemption Provisions

The KFTC can uphold Article 19 MRFTA for vertical agreement cases with a slight amendment to the exemption clause. If the KFTC implements Article 19 for vertical agreements also, the legal provision should ensure the exemption which is indispensable for the market. To achieve this aim, the KFTC needs to amend the notification method under Article 19(2) to the block exemption system. Article 19(2) provides exemptions where the business practices satisfy the criteria of industrial rationales, such as Research and Development (R&D), or enhancement of the SMEs' competitiveness by the authorisation of the KFTC in horizontal cases. However, if consumer interests are significantly harmed, this

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<sup>67</sup> Some argue that this AML provision still covers only agreements between competitors. See Masako Wakui, *Supra.*, note 64, p. 5.

<sup>68</sup> Joint Cases 56 and 58/64, *Établissements Consten SA & Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, 339-40, [1966] CMLR 418.

<sup>69</sup> See Min Ho Lee, 'Recent Developments in the Treatment of Collusion by Korean Courts', *Journal of Korean Law*, Vol. 4, No. 2, 2005, p. 159.

<sup>70</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 10, p. 228.

exemption will not be granted.<sup>71</sup> Although the KFTC provides exemption by authorisation, the number of cases of exemption, especially in horizontal cases, is very small.<sup>72</sup> The major problems are: (i) enterprises do not acknowledge the authorisation system of exemption; (ii) they believe it would be difficult to obtain exemption through this system; and (iii) they are not willing to expose their anti-competitive schemes.<sup>73</sup> Since enterprises are not willing to take the risk of failure of the exemption grant, this exemption provision does not work properly.

Unless the KFTC applies this provision to vertical cases with the block exemption method, enterprises will hardly recognise the benefits. The purpose of exemption should be to provide a framework for self-regulation which permits economic entities to organise their vertical practices, so as to obtain legal protection from the application of law as provided in the EC.<sup>74</sup> The KFTC can adopt the technical methods of Article 81(3) EC. The prohibition of agreements contained in Article 81(1) EC is tempered by Article 81(3) EC, which provides that an arrangement infringing Article 81(1) EC may still receive benefits from exemption. This exemption is granted if the agreement contributes to improving the production or distribution of goods, or to promoting technical or economic progress, whilst allowing consumers a fair share of the resulting benefits. However, this exemption cannot be allowed where (i) the agreement is not indispensable to the attainment of these objectives; or (ii) there is a possibility of eliminating competition in respect to a substantial part of the products.<sup>75</sup>

Whilst considering this, the KFTC also needs to focus on *de minimis* rule. If Article 19 MRFTA prohibits all possible anti-competitive agreements, irrespective of the size of the firms in question, or the impact that the agreement will have, this provision would paralyse business activity in the Korean market.<sup>76</sup> Article 19, along with a *de minimis* provision of 10 per cent of market share under Article 4 MRFTA, can give a guarantee of efficient and pro-competitive results by vertical arrangements. Therefore, vertical agreements under an Article

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<sup>71</sup> Art. 29(2) of the Enforcement Decree.

<sup>72</sup> The number of authorised concerted cases since this legislation is only 8. This indicates that the KFTC applies this exemption with a strict limitation. See Jungwon Song, *Ca-Ru-Tel-Mit-Bul-Gong-Jung-Go-Rae-Hang-Wi-Kyu-Jae [Regulations on Cartels and Unfair Business Practices]*, Pakyoungsa, Seoul, 2005, p. 162.

<sup>73</sup> See Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 6th edn, Bubmunsa, Seoul, 2008, p. 270.

<sup>74</sup> For further details about block exemption in the EC, see Rosa Greaves, *EC Block Exemption Regulations*, Chancery Law Publishing, Chichester and Colorado Springs CO, USA, 1994, p. 3.

<sup>75</sup> See Joanna Goyder, *EU Distribution Law*, 4th edn, Hart Publishing, Oxford, 2005, pp. 30-32.

<sup>76</sup> Compare with the EC *de minimis* Notice rationale [OJ 2001, C368/13]. See also Mark Furse, *Supra*. Note 21, pp. 215-7.



19(2) scrutiny should be considered lawful if the practice satisfies one of the following criteria: (i) the enterprise arranging vertical restraints lacks market power; and the agreement should (ii) improve production and distribution, (iii), enhance R&D, (iv) promote the state economy, (v) improve competitiveness of SMEs, and (vi) should not increase its benefits by harming consumers.<sup>77</sup>

Since vertical restraints or mergers without market power can be lawful in many regimes, the KFTC and the courts should take the sensible position that a vertical arrangement is a method of normal business conduct. Indeed, a vertical merger is still lawful even when the post-merger enterprise is monopolist at one level.<sup>78</sup> However, vertical restraints have been treated differently, as quasi-per se unlawful, when the enterprises involved possess market power. Often the best the KFTC can do is to offer a guidance of possibilities of some pro- and anti-competitive effects by vertical restraints. When the anti-competitive explanation has been eliminated, the pro-competitive justification will be left.<sup>79</sup> This examination should be done mainly under Article 19.

The overall suggestion can give the KFTC full authority to curb anti-competitive abusive conduct of dominant enterprises under Article 3-2. Then, Article 23 will be considered a provision on unilateral conduct which does not fall within the scope of Article 3-2. The legislative intent of Article 23 should be its function in a manner supportive of the provision of Article 3-2. In other words, its broader purpose of preventing anti-competitiveness will cover effective implementation of the MRFTA, which could not be covered by Article 3-2.<sup>80</sup> After that, the KFTC, the courts, competition law practitioners, and enterprises may get a sufficient degree of guidance, which will result in overall benefits fitting the aims of competition law. Moreover, this amendment and implementation of Articles 19 and 23 can offer benefits through pro-competitive business practices.

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<sup>77</sup> See Frank Easterbrook, 'Vertical Arrangements and the Rule of Reason', *Antitrust Law Journal*, Vol. 53, 1984, p. 159. This idea is mostly from the author's suggestion.

<sup>78</sup> Under sec. II.1.(5)(A) of the M&A Review Guidelines [amendment by the KFTC Notification No. 2007-12, Dec. 20, 2007], the safe harbour provision for vertical and conglomerate mergers has more tolerant Herfindahl-Herschman Index (HHI) threshold than horizontal.

<sup>79</sup> Frank Easterbrook, *Supra.*, note 77, pp. 143-5.

<sup>80</sup> This intention is originated from the UBP provision in Japan. See Masako Wakui, *Supra.*, note 64, pp. 104-5.

Although Article 19 prohibits vertical agreements, Article 23 should remain to control various anti-competitive or unfair unilateral offences. Therefore, this UBP provision of Article 23 should also include an exemption clause that ensures efficient and pro-competitive vertical restraints. Otherwise, the unilateral or coordinating vertical arrangements that are pro-competitive can be prohibited. Therefore, Article 23 should include similar block exemption criteria to Article 19.

#### 6.4. Amendment to Provision of RPM: Article 29 MRFTA and RPM Guidelines

##### 6.4.1. Withdrawal of Article 29 MRFTA

As discussed in the previous chapter, the KFTC needs to consider change of RPM policy. Unlike the US, the KFTC still seems to take minimum RPM as a per se violation, and imposes significant penalties on those found to have participated in such a practice.<sup>81</sup> The economic consequences of this RPM are not undesirable in most circumstances, because most are beneficial to consumers, distributors, and manufacturers alike.<sup>82</sup> Moreover, the ruling to separate vertical price restraints from non-price restraints is unwise. Every vertical arrangement is designed to influence price. If, for example, territorial restrictions induce dealers to supply additional services and information, they do so only because they can raise the price, and thus call forth competition in the service dimension. If a vertical restriction is the way of compensating distributors for lending their reputations, they must affect price in order to provide that compensation.<sup>83</sup>

Despite this argument, the MRFTA is almost the only statutory provision on RPM with an individual exemption by KFTC authorisation. The US Congress once gave the States the right to authorise RPM for sales within their borders in 1937,<sup>84</sup> responding to the US

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<sup>81</sup> E.g., *Hewlett-Packard Korea*, KFTC Decision 2005-160, 2005Jaedo0452, Oct. 25, 2005; *Epson Korea Corp.*, KFTC Decision 2005-163, 2005Jaedo0454, Oct. 31, 2005. This hard-core approach is similar to the EC, e.g., *Yamaha* (IP/03/1028), 16 July 2003. The EC Commission imposed fines for practices designed for fixing RPM of its products in certain Member States.

<sup>82</sup> For further discussion, *Supra.*, Chapter 3. See also Walter Adams, 'Resale Price Maintenance: Fact and Fancy', *The Yale Law Journal*, Vol. 64, No. 7, 1955, p. 974.

<sup>83</sup> Frank Easterbrook, *Supra.*, note 77, p. 156.

<sup>84</sup> The Miller-Tydings Act of 1937, 50 Stat. 693. For further discussion about this Act evaluated as desirable, see Walter Adams, *Supra.*, note 82, pp. 972-4.

Supreme Court's per se judgment.<sup>85</sup> This was understood as putting small manufacturers on an equal stance with their large rivals.<sup>86</sup> However, 40 years later, the regulation for authorisation by US enforcement authorities was withdrawn, and the per se rule restored for all states by the Consumer Goods Pricing Act.<sup>87</sup> The US courts, however, recognised RPM as one efficiency-enhancing practice like other types of vertical non-price restraints. The US Supreme Court has abandoned the per se rule on minimum RPM, and held that the *Dr. Miles*<sup>88</sup> precedent should be overruled and judged by the rule of reason in *Leegin*.<sup>89</sup>

Unlike current US antitrust law, Article 29 MRFTA simply gives the KFTC exemption power regarding a certain type of vertical price practice, especially in the publishing industry.<sup>90</sup> The Article 29 authorisation method seems a product heated debate on vertical restraints during the 1970s in the US, just before the MRFTA legislation in 1980, and the ideal of legislation on cartel control in Japan.<sup>91</sup> However, the Korean RPM provision is very distinctive. Other regimes, including Japan, do not have this type of statement in their acts.<sup>92</sup> This regulatory provision does not give efficiency-enhancement and thus, may impede pro-competitive practices. As US historical development in RPM legislation and case law shows, it is not an easy task for competition authorities to justify minimum RPM, and is controversial. There have been arguments by competition economists and lawyers as to whether minimum RPM should be treated by the per se rule or rule of reason. Nonetheless, reviewing the economic literature on vertical restraints reveals two basic considerations that make a rule of reason standard superior to a per se standard in the treatment of minimum RPM. First, there is no clear basis in either economic theory or empirical evidence favouring

<sup>85</sup> *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 31 S.Ct. 376 (1911).

<sup>86</sup> For details of history, see William Baldwin, *Market Power, Competition, and Antitrust Policy*, Homewood, Illinois, USA, 1987, pp. 462-3; Rudolph Peritz, *Competition Policy in America: History, Rhetoric, Law*, Oxford University Press, New York, 1996, pp. 153-6.

<sup>87</sup> The Consumer Goods Pricing Act of 1975, 89 Stat. 801. See also Herbert Hovenkamp, *Supra.*, note 11, pp. 55-6.

<sup>88</sup> *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 31 S.Ct. 376 (1911). For more details of historical development of per se and rule of reason in the US courts of RPM, see *Ibid.*, pp. 471-9.

<sup>89</sup> *Leegin Creative Leather Products, Inc. v. PSKs, Inc.*, 551 U.S. (2007). There have been a lot of arguments over the per se rule in the US antitrust history before *Leegin* case. Some argue that there was no obvious per se reason for per se rules in the US antitrust. For further discussion, see John McGee, 'Why Not "Deregulation" for Antitrust?' in Eleanor Fox and James Halverson (eds), *Industrial Concentration and the Market System: Legal, Economic, Social and Political Perspectives*, ABA Publishing, USA, 1979, p. 58.

<sup>90</sup> The exemption for publication sector under the MRFTA seems the influence of Art. 30 of the GWB.

<sup>91</sup> Masako Wakui, *Supra.*, note 64, pp. 13-6. The intervention of the Japanese government in the 1940s created an authorisation system, even in cartels or international agreements. Moreover, the amendment in 1953 adopted an exemption system of cartel and RPM. This was regarded as less stringent and the AML was rarely enforced in the 1950s.

<sup>92</sup> The Japanese UBP provision under Art. 19 AML also covers RPM cases.

the per se prohibition of RPM. Second, there is no basis in either logic or public policy interests for treating vertical price restraints differently from non-price vertical restraints, which can have the same motivation and accomplish the same effects.<sup>93</sup> Article 29, however, curbs the KFTC's full examination of efficiency in RPM, since it treats minimum RPM as per se violation.

Furthermore, Article 29 may overlap the application of Articles 3-2 and 19, since these already prohibit price arrangements.<sup>94</sup> In theory, Article 3-2 can be also applicable to unilateral price fixing cases. Moreover, if Article 19 applies to vertical arrangements, Article 19, as a major provision for RPM, can also cover RPM cases. However, in practice, Article 29 is applied regardless of market power, or even being concerted or unilateral. This dilemma can be seen in the *Korea Ginseng Corp.* case.<sup>95</sup> The firm had a 71.3 per cent market share that could be presumed as market dominance under Article 4, but the KFTC decided it was violation of Article 29, regardless of its market share. Considering all of this, it would be desirable to withdraw Article 29. In addition, since RPM practices can be pro-competitive, the KFTC should withdraw RPM provision, and apply Article 19 with block exemption.<sup>96</sup> Then, the courts can develop a rule of reason approach through case law. The KFTC and the courts have failed to provide a coherent rationale for upstream enterprises' interest in enforcing RPM, by their wrongful analogy between vertical and horizontal agreements. Although vertical restraints such as RPM do not always have the exact same effect as horizontal agreements, the KFTC and the courts have treated RPM as a hard-core restriction. However, subsequent economic literature and other competition regimes' current approach to vertical price restraints elaborate upon this distinction.<sup>97</sup>

As discussed in Chapter 5, suppliers of luxury goods such as cosmetics and foreign car importers monitored retail prices, and threatened to terminate non-complying retailers. Nevertheless, there might have been a rationale of their RPM schemes for supplying products,

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<sup>93</sup> See Robert Lerner, 'Vertical Price Restraints: Per se or Rule of Reason?' in Robert Lerner and James Meehan, Jr. (eds), *Economics and Antitrust Policy*, Quorum Books, Westport, Connecticut, USA, 1989, p. 126.

<sup>94</sup> Some scholars also argue that Article 23 might be applicable to RPM cases. See Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, p. 312.

<sup>95</sup> *Korea Ginseng Corp.*, KFTC Decision 2002-041, 2001Jeonsa4681, Jan. 29, 2002.

<sup>96</sup> See Ju-Sun Lee, 'Competition Policy on Unfair Business Practices and Resale Price Maintenance' in Seung-Hee Jwa, *Thoughts of Amendment of the Monopoly Regulation and Fair Trade Act*, Korea Economy Research Institute, 2004, pp. 401-2; Ohseung Kwon, *Supra.*, note 8, p. 16.

<sup>97</sup> See George Hay, 'Vertical Restraints After Monsanto', *Cornell Law Review*, Vol. 70, Mar. 1985, p. 422.

by guaranteeing product quality as well as pre-sale services in *Cosmetics* cases.<sup>98</sup> The firms in these cases had a sufficient reason to have RPM for entering into a new market. Furthermore, only if an enterprise does have significant market power should it be regarded as quasi-hard-core vertical restraints. However, the KFTC has treated these RPMs as per se infringements, despite their small market shares. In conclusion, the KFTC should provide flexible guidelines for RPM practices, which allow enterprises to benefit from the rule of reason. The current RPM Guidelines do not state clearly which type of RPM can infringe the law. This problem has misled the market entities. Different types of vertical restraints can be substituted for each other,<sup>99</sup> so that there is no reason for distinct rules. Therefore, the different treatment of price and non-price restraints is not plausible.<sup>100</sup> If the current Article 29 is withdrawn, the RPM Guidelines should follow the same step. Instead, the new vertical guidelines, which will be discussed below, should provide safe harbour and guarantee the efficiency justification for pro-competitive practice, regardless of price or non-price restraints.

## 6.5. Modernisation: Establishment of Korean Vertical Guidelines

### 6.5.1. Withdrawal of Per Se Provision with Caution<sup>101</sup>

The KFTC currently provides the UBP and the RPM Guidelines as guidance for vertical restraints. However, these guidelines do not have an adequate level of balancing pro- and anti-competitiveness by vertical restraints. Furthermore, these are unnecessary where the new guidelines cover both vertical price and non-price restraints. The KFTC guidelines are important for guidance in vertical cases where the courts do not have sufficient understanding of vertical restraints, which can improve the rule of reason development. Examining historical developments through landmark cases in the US, the US Supreme Court began, in

<sup>98</sup> E.g., *LG Health Corp.*, KFTC Decision 2002-367, 2002Danchae1696, Dec. 24, 2002; *L'Oreal Korea*, KFTC Decision 2002-368, 2002Danchae1700, Dec. 24, 2002. See also Howard Marvel and Stephen McCafferty, 'Resale Price Maintenance and Quality Certification', *The RAND Journal of Economics*, Vol. 15, No. 3, 1984, pp. 358-9.

<sup>99</sup> See Frederic Mathewson and Ralph Winter, 'An Economic Theory of Vertical Restraints', *The RAND Journal of Economics*, Vol. 15, No. 1, 1984, pp. 27-38.

<sup>100</sup> Roger Van den Bergh and Peter Camesasca, *Supra.*, note 49, p. 242.

<sup>101</sup> See Ohseung Kwon, 'Gong-Jung-Go-Rae-Bub-Ui-Kae-Yo-Wa-Jaeng-Jom (Introduction to Fair Trade Law and Issues) in Ohseung Kwon (ed), *Ja-Yoo-Kyoung-Jaeng-Kwa-Gong-Jung-Go-Rae [Free Competition and Fair Trade]*, Bubmunsa, Seoul, 2002, p. 17. The author argues that RPM provision is unnecessary because Art. 23 may cover RPM as a type of UBP. However, Art. 19 should be more appropriate as discussed above.

the *Sylvania* case, to recognise the rule of reason as a primary standard of antitrust analysis, inspired by economic theories. This gave new prominence to the economic approach to US antitrust law.<sup>102</sup> It holds that the market impact of vertical restraints is complex, because of their potential for restriction on intra-brand competition, and also stimulation of inter-brand competition. However, inter-brand competition became the primary concern of US antitrust law.<sup>103</sup>

Korean vertical guidelines should take this into account. They should guarantee efficiency justification based on an inter-brand competition analysis for vertical restraint, without market power. For the progressive development of new vertical guidelines, the KFTC must distinguish between price and non-price restraints. Regarding non-price restraints, first, the KFTC needs to illustrate how these can encourage dealer investments on pre-sale services, in order to develop consumer demand for goods. Second, it should scrutinise whether vertical non-price restraints may be designed to promote inter-brand competition. Third, it should examine whether vertical non-price restraints can usefully encourage specialisation in distribution. These pro-competitive justifications are persuasive, because the ensured return, such as recoupment of investment by suppliers, gives more confidence in their business profits.<sup>104</sup>

With regards to price restraints, the guidelines should also articulate that some restraints, such as minimum RPM, can still be regarded as quasi-per se illegal, although all other vertical restraints, including maximum and recommended RPM, should be examined under the full rule of reason. The KFTC can consider minimum RPM as pro-competitive, with, of course, caution. This standard of the quasi-per se approach for minimum RPM requires pre-existing market power. It does, however, allow for the possibility that a party that does not possess market power will acquire it through minimum RPM, with other methods of non-price restraints, by increasing competitors' distribution costs. This may impede competition.<sup>105</sup> Furthermore, there is a major reason why the KFTC needs to treat

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<sup>102</sup> *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) at 49-52. See also Richard Posner, 'The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision', *The University of Chicago Law Review*, Vol. 45, No. 1, 1977, p. 20.

<sup>103</sup> *Leegin Creative Leather Products, Inc. v. PSKs, Inc.*, 551 U.S. (2007). See also ABA, *Antitrust Law Developments*, Vol. I, 6th edn, ABA Publishing, Chicago, 2007, pp. 148-9.

<sup>104</sup> Einer Elhauge and Damien Geradin, *Supra.*, note 10, p. 651.

<sup>105</sup> Kevin Arquit, *Supra.*, note 7, p. 930.

minimum RPM with special caution. Minimum RPM can make it easier for suppliers to maintain cartel prices than maximum or recommended RPM. If retail prices are fixed, a manufacturer will have little incentive to reduce prices.<sup>106</sup> Therefore, the KFTC should give attention to minimum RPM, despite withdrawal of its per se illegal approach. Through the provisions of block exemption, based on revised Articles 19 and 23 MRFTA, the suggested vertical guidelines should allow exemptions to pro-competitive and efficient vertical restraints, where there is no threat from market power. However, the guidelines should provide a quasi-hard-core restriction on practices of minimum RPM, combined with other vertical non-price restraints, as shown in the KFTC's enforcement.<sup>107</sup>

#### 6.5.2. One-Fits-All Approach: New Safe Harbour and Pursuit of Legal Certainty

The way to solve problems of trade-off between pro- and anti-competitive effects by vertical restraints will be the central issue in the new vertical guidelines. To allow a positive impact on the competition by vertical restraints, competition authorities should practise (i) market power examination; and (ii) an anti-competitiveness test. To establish legal certainty in efficient vertical practices, the KFTC should examine the first criterion of the market share threshold test. The current exemption clause of 10 per cent market share under the UBP Guidelines does not guarantee the efficiency justification. Therefore, the KFTC needs to establish the most effective market share threshold test, based on sufficient degree of tolerance. Therefore, the KFTC should create a new safe harbour to fit the efficiency-justified policy, for ensuring legal certainty. This safe harbour provision is held in the EC as an important step towards a more economics-based approach.<sup>108</sup>

The EC competition authority has a good example of competition policy on vertical restraints with a statutory provision. Article 81(1) EC prohibits vertical agreements which

<sup>106</sup> See Don Waldman and Elizabeth Jensen, *Industrial Organization*, 3rd edn, Addison Wesley, USA, 2007, p. 577.

<sup>107</sup> The following cases showed that RPM together with other vertical restraints can increase the possibility of violation, e.g., *Taepyoungyang Cosmetics*, KFTC Decision 2002-366, 2002Danchae1702, Dec. 24, 2002; *Nomshim Corp.*, KFTC Decision 2004-036, 2003Danchae2188, Feb. 11, 2004; *Haitai Corp.*, KFTC Decision 2004-041, 2003Danchae2189, Feb. 11, 2004; *Lotte Chilsung Corp.*, KFTC Decision 2004-039, 2003Danchae2190, Feb. 11, 2004; *Woongjin Food Corp.*, KFTC Decision 2004-185, 2003Kyoungchok0423, 0424, 0550, June 7, 2004; *Daeho Corp.*, KFTC Decision 2005-168, 2005Jonsa0500, Sept. 6, 2005; *Decori Corp.*, KFTC Decision 2006-436, 2006Sokyoung0733, Dec. 18, 2006; *Biontech Corp.*, KFTC Decision 2007-127, 2006Sokyoung2748, May 17, 2007; *Woongjin Kutchen Corp.*, KFTC Decision 2008-216, 2007Sokyoung2398, May 20, 2008.

<sup>108</sup> Romano Subiotto, *Supra.*, note 25, pp. 192-3.

distort competition within the common market. However, Article 81(3) EC, EC vertical regulation,<sup>109</sup> and vertical guidelines<sup>110</sup> provide exemptions from specific categories of vertical restraints and concerted practices.<sup>111</sup> The EC Commission is well aware that vertical restraints can have negative effects on competition only where significant market power exists.<sup>112</sup> Thus, the EC Commission works within two parameters: (i) the nature of the vertical restraint; and (ii) the level of market power involved.<sup>113</sup> Where a supplier's market share does not exceed 30 per cent, it will get block exemption benefits, unless the agreement contains hard-core restrictions, such as minimum RPM or absolute territorial restriction.<sup>114</sup> For the modernisation of vertical guidelines in Korea, the KFTC should undertake similar parameters, of understanding the nature of vertical restraints and market power since the current UBP and RPM guidelines produce only 'strait-jacket effects' from the white and black lists, which were observed in the old EC approaches.<sup>115</sup> These guidelines, providing complicated lists of violations, may even confuse economic entities and lawyers, because each section of the list may overlap Article 3-2 provision.

A market share threshold test is important to prevent possible abuse, since it is more likely for enterprises to get exemptions through tolerant policy on vertical restraints when they do not have some degree of market power.<sup>116</sup> The EC vertical regulation and guidelines provide market share threshold guidance for benefits such as legal certainty. These not only prevent possible abuse from an undertaking's market power, but also allow economic justifications for pro-competitive vertical agreements. The US Department of Justice (DOJ)

<sup>109</sup> Regulation 2790/99 OJ L336/21.

<sup>110</sup> Commission Notice, Guidelines on Vertical Restraints [2000] OJ C 291/01, [2000] 5 CMLR 1074.

<sup>111</sup> *De minimis* Notice [OJ 2001, C368/13] also gives guidance of the safe harbour rule for exemptions.

<sup>112</sup> See Vicent Verouden, 'Vertical Agreements and Article 81(1) EC: The Evolving Role of Economic Analysis', *Antitrust Law Journal*, Vol. 71, 2003, pp. 526-7.

<sup>113</sup> Roger Van den Bergh and Peter Camesasca, *Supra.*, note 49, p. 236.

<sup>114</sup> See para. 116(2) of EC vertical guidelines. It states that territorial restriction may be necessary to recoup the investment to open up or enter new markets. Therefore, only absolute territorial protection may be regarded as a hard-core restriction. For further explanation about hard-core restrictions, see also Roger Van den Bergh, 'The Difficult Reception of Economic Analysis in European Competition Law' in Antonio Cucinotta, Roberto Pardolessi and Roger Van den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, pp. 40-42.

<sup>115</sup> See Richard Whish, 'Recent Developments in Community Competition Law 1998/99', *European Law Review*, Vol. 25, No. 3, 2000, pp. 228-9; Joanna Goyder, *Supra.*, note 75, p. 65. The old approach in the EC was widely criticised as too rigid and formalistic. See also Ohseung Kwon, *Supra.*, note 30, pp. 330-31; Ki-Su Lee and Jin-Hee Ryu, *Supra.*, note 94, pp. 204-5. Lee and Ryu argue the current provision in the guidelines of exemplified black list gives its flexibility of implementation with somewhat legal certainty. However, Kwon criticised the guidelines for the 'strait-jacket' reason.

<sup>116</sup> E.g., para. 116 of the EC vertical guidelines. The EC Commission recognises the free-riding problem enough to justify vertical restraints that do not harm competition in the market. Nevertheless, the EC Commission is concerned more about pre-sale services. Therefore, free-riding justification might not apply to after-sale services.



used to have guidelines for vertical restraints, providing market share threshold test, which is now withdrawn.<sup>117</sup> The US guidelines utilised a screen of 10-20 per cent for territorial, customer restraints, and exclusive dealing, and 30 per cent for tying. Some US courts have also applied the market power screen. These courts examine whether the supplier had enough market power to increase and sustain its dominant position through vertical restraints.<sup>118</sup> However, not all courts apply this test, and only few legal commentators agree with this. Some US commentators still criticise rulings in tying cases such as *Kodak*,<sup>119</sup> in which the court emphasised unnecessarily the possibility of gaining market power by lock-in effects.<sup>120</sup> They argue that *Kodak* had a small market share of the overall inter-brand market.<sup>121</sup> The US antitrust regime is, therefore, sometimes reluctant to strictly apply a market share threshold test.

Comparing the two regimes' approaches regarding the market share threshold test, the EC provision is more suitable for the Korean regime, since it gives more legal certainty, appropriate to the civil law system. Along with this market share threshold, the KFTC can also adopt flexibility in application of the law by the rule of reason development, originated in the US. To summarise, an appropriate degree of market share threshold test should be included in core Korean vertical guidelines to give the benefit of legal certainty. However, even if the KFTC can reduce administrative costs from block exemption in vertical cases, it is also possible that the costs from market definition in each case may outweigh the benefits from investigation of vertical arrangements. Nevertheless, Articles 3-2 and 23 enforcements have already required improvement on better techniques for assessing market power and

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<sup>117</sup> The now-withdrawn 1985 Vertical Restraints Guidelines of the Department of Justice. For further discussion, see also Charles Rule, 'Statement of Charles F. Rule Acting Assistant Attorney General Antitrust Division before the Committee on the Judiciary United States Senate Concerning the Justice Department's Vertical Restraints Guidelines on July 16, 1985', *Antitrust Law Journal*, Vol. 54, 1985, p. 381.

<sup>118</sup> In the US, 70 per cent of market share can be evidence of monopolisation, whilst 30 to 35 per cent may be an infer a possible monopolisation attempt. However, the US antitrust authorities do not provide clear guidelines for this, e.g., *Zschaler v. Claneil Enters. Inc.*, 958 F. Supp. 929 (D. Vt. 1997). See also Janet McDavid and Richard Steuer, 'The Revival of Franchise Antitrust Claims', *Antitrust Law Journal*, Vol. 67, 1999, p. 239.

<sup>119</sup> *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 112 S. Ct. 2072 (1992).

<sup>120</sup> See Benjamin Klein, 'Market Power in Antitrust: Economic Analysis after Kodak', *Supreme Court Economic Review*, Vol. 3, 1993, pp. 47-63. For further theoretical discussion in *Kodak*, see also Carl Shapiro, 'Aftermarket and Consumer Welfare: Making Sense of Kodak', *Antitrust Law Journal*, Vol. 63, 1995, pp. 483-511.

<sup>121</sup> See Frank Taney, 'Rewriting the Law of Resale Price Maintenance: The Kodak Decision and Transaction Cost Economics', *University of Pennsylvania Law Review*, Vol. 143, No. 1, 1994, pp. 361-2; Richard Steuer, 'Vertical Restraints in the Nineties', *Antitrust Law Journal*, Vol. 62, 1994, pp. 721-2.

defining markets.<sup>122</sup> Korean policy-makers should, therefore, make details of criteria of the market share threshold test. Then, the new vertical guidelines will clarify the application of provisions Articles 3-2, 19, and 23 MRFTA to offer legal certainty, as shown in the table below.

		Above 50%	30-50 %	10-30%	Below 10%
Article 3-2 MRFTA Abuse of Market Dominance	Horizontal	Applicable	Applicable	Not applicable	<i>De minimis</i> Exemption
	Vertical	Applicable	Not applicable	Not applicable	<i>De minimis</i> Exemption
Article 19 MRFTA Unfair Concerted Practices	Horizontal	Applicable	Applicable	Applicable	Exemption except hard-core
	Vertical	Applicable	Applicable	Block exemption	Exemption except quasi-hard core
Article 23 MRFTA Unfair Business Practices	Horizontal	Not applicable	Not applicable	Applicable	<i>De minimis</i> Exemption
	Vertical	Not applicable	Not applicable	Applicable	<i>De minimis</i> Exemption

Table 6.1. Application of law based on market share threshold and types of violations according to the suggested amendments

Some Korean scholars argue that the rule of reason approach should not be implemented in certain provisions in the MRFTA. According to them, Article 3-2 cannot be interpreted under the rule of reason, because it cannot be evaluated persuasively based on purely economic analysis. It can be inferred that illegality of conduct by market dominant enterprises is likely to be more widely accepted than in a monopolisation approach in the US, where the rule of reason may work. This concept takes a stricter view on unilateral unfair practices of market dominance. However, as marked before, because the criteria are not exclusively based on economic principles, firms would have difficulty predicting when and

<sup>122</sup> This assessment technique is the common phenomenon and also requirement worldwide. Therefore, this has been more developed around the world than before. See Philip Areeda, 'Monopolization, Mergers, and Markets: A Century Past and the Future' *California Law Review*, Vol. 75, No. 3, 1987, p. 960.

under what circumstances their conduct could be challenged or not.<sup>123</sup> Therefore, the development of the rule of reason should be made by the courts, along with the new vertical guidelines. Addition to this, the new guidelines should also articulate the standards for finding evidence of a vertical agreement, which has been discussed by means of the US ‘Colgate doctrine’,<sup>124</sup> or the standard of proof of an agreement in the EC,<sup>125</sup> in order to support the market share threshold test.

If the KFTC maintained the current provisions, which do not distinguish between agreements and unilateral policy, but focus on practices, it would continue confusing applications of Articles 3-2 and 23 with Article 19. The Korean standards from the *Maeil* and *Namyang* cases<sup>126</sup> do not give a sufficient degree of standard of evidence.<sup>127</sup> A further development in vertical guidelines by details of criteria is necessary for clear evidence to establish that downstream firms have agreed or acquiesced, explicitly or tacitly, in any unilateral policy declared by upstream firms. The scrutiny for existence of agreements is not an easy task, and this is not a problem unique to Korea. In the Japanese *Shiseido* case,<sup>128</sup> the JFTC’s decision also did not give clear guidance for this distinction. This case was merely

<sup>123</sup> Bong Eui Lee, *Supra.*, note 9, pp. 71-2.

<sup>124</sup> *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919) and *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984). Unilateral suggestion of RPM followed by refusal to deal does not constitute agreement. See also ABA, *Antitrust Law and Economics of Product Distribution*, ABA Publishing, Chicago, 2006, p. 87.

<sup>125</sup> The EC case law has developed the distinction between vertical agreements and unilateral practice. In the Case 107/82, *AEF-Telefunken v. Commission* [1983] ECR 3151, [1984] 3 CMLR 325, the ECJ found that the systemic refusal to supply, which did not adhere to the pricing policy, arose out of the agreement between AEG and its resellers. In Case 277/87, *Sandoz Prodotti Farmaceutici SpA v. Commission* [1990] ECR I-45, [1990] 4 CMLR 242, the ECJ also affirmed the EC Commission’s decision. *Sandoz*’s policy did not constitute conduct but formed part of the general framework of commercial relations for its constituting a tacit agreement. However, in Case T-41/96, *Bayer AG v. Commission* [2000] ECR II-3383, [2001] 4 CMLR 126, *aff’d* on appeal Cases C-2&3/01 P, [2004] ECR I-23, [2004] 4 CMLR 653, the Court of First Instance (CFI) and the ECJ stressed that it was not open for the EC Commission automatically to assume that the expression of a unilateral practice by one party established an agreement. Such a broad approach would confuse Art. 81 with 82 EC. Proof of an agreement under Art. 81 should be found upon the direct or indirect findings of a concurrence of wills between economic entities. For further discussion, see also Alison Jones and Brenda Sufrin, *EC Competition Law: Text, Cases, and Materials*, 3rd edn, Oxford University Press, Oxford, 2008, pp. 148-68; Barbora Jedlickova, ‘Boundaries between Unilateral and Multilateral Conducts in Vertical Restraints’, *European Competition Law Review*, Vol. 29, No. 10, 2008, pp. 602-6.

<sup>126</sup> *Namyang Dairy Products Co. v. KFTC*, Supreme Court 99Du11141, Dec. 24, 2001; *Maeil Dairy Industry Ltd v. KFTC*, Supreme Court 2000Du1829, May 31, 2002.

<sup>127</sup> Under the Art. 19(5) MRFTA, however, the existence of an agreement is presumed despite the absence of an explicit agreement to engage in anti-competitive practices. The burden of proof whether or not an agreement existed is on the parties, e.g. *Dong-Suh Food, Inc. and Nestlé Korea Inc. v. KFTC*, Supreme Court 2000Du3184, May 2, 2002; *Four Toilet Companies v. KFTC*, Supreme Court 2000Du1386, May 28, 2002. This was introduced to lessen the difficulties of proof of collaboration, but many criticise this presumption. This is very different from other regimes’ presumption criteria, and shall not be applicable to vertical cases. For further discussion, see Ohseung Kwon, *Supra.*, note 8, p. 15; Min Ho Lee, *Supra.*, note 69, pp. 162-7.

<sup>128</sup> *Shiseido Co., Ltd.*, JFTC consent Decision, Nov. 30, 1995, *Shinketushu* 42-97.

understood to be an example of a tacit agreement forming an RPM through its instruction of price.<sup>129</sup> Without clear guidance, the courts in Korea and Japan may have difficulties solving categorisation of the concerted and unilateral.

Considering all of the references from the comparative study, the KFTC and the Korean courts need to develop the meaning of standards of proof in vertical agreements, such as developed in the US *Colgate* case,<sup>130</sup> and also the EC cases,<sup>131</sup> *Bayer AG*<sup>132</sup> and *Volkswagen*.<sup>133</sup> In *Maeil* and *Namyang*, the Supreme Court should have articulated the conditions for presumption in the test of agreement. A manufacturer can unilaterally announce its pricing policy, and that it would not deal with distributors who refused to adhere to the RPM. Then, the practice of coercing a dealer to adhere to its retail pricing policy as a condition of supplying goods can be found liable for vertical price-fixing.<sup>134</sup> The KFTC and the courts should accept the establishment of this standard of vertical agreement proof. The new vertical guidelines will help the KFTC and the courts have a better objective justification in vertical cases, through giving guidance regarding these issues.

### 6.5.3. Supplementary Factors Considered for New Guidelines: Inter-brand Competition

To examine the anti-competitiveness test after the safe harbour scrutiny is not an easy task, because it is difficult to weigh inter- and intra-brand competition against each other. However, there are several reasons why the KFTC should outweigh inter-brand competition. The reduction in intra-brand restraint for improving inter-brand competition is the source of the

<sup>129</sup> This was the influence of the Supreme Court of Japan judgment in *Wakodo*, July 10, 1975, *Saiko Saibansho Minji Hanreishu (Minshu)* 29-6-888. The Court held that the economic disadvantage from the restrictive term which could be observed effectively is sufficient to find a violation. See also Masako Wakui, *Supra.*, note 64, pp. 154-5.

<sup>130</sup> *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 US 717 (1988) at 735-736. In *Sharp*, the Court established that a vertical restraint is not per se illegal unless it contains some agreement on price or price level.

<sup>131</sup> For further discussion about the EC's approach to unilateral conduct and Article 81 EC in vertical cases, Richard Whish, *Supra.*, note 40, pp. 107-13.

<sup>132</sup> Case T-41/96, *Bayer AG v. Commission* [2000] ECR II-3383, [2001] 4 CMLR 126, *aff'd* on appeal Cases C-2&3/01 P, [2004] ECR I-23, [2004] 4 CMLR 653.

<sup>133</sup> Case T-208/01, *Volkswagen v. Commission* [2003] ECR II-5141, [2004] 4 CMLR 14, *aff'd* Case C-74/04 P, [2006] ECR I-6585. For further discussion regarding unilateral conduct and agreements, see also Mario Filipponi, Luc Peepers and Donnadh Woods, 'Vertical Agreements' in Jonathan Faull and Ali Nikpay (eds), *The EC Law of Competition*, 2nd edn, Oxford University Press, Oxford, 2007, pp. 1138-41; Alison Jones and Brenda Sufrin, *Supra.*, note 125, p. 168; Mark Furse, *Supra.*, note 21, pp. 179-80.

<sup>134</sup> This may be clear as seen in the US approach in *Colgate*. For further discussion, see Douglas Broder, *A Guide to US Antitrust Law*, Sweet & Maxwell, London, 2005, p. 59.

competitive benefit that helps one product compete against another.<sup>135</sup> Vertical restraints which affect intra-brand competition, therefore, do not raise many welfare problems. Accordingly, most economists argue that intra-brand restraints are not worth investigating when no market power exists.<sup>136</sup> To achieve the best test of balance, seeking alternative means is crucial. If there is no alternative, the probability of efficiency from the practices will increase. The new vertical guidelines should, hence, include criteria for analysing whether there are less restrictive means as an alternative to the vertical restraints in question. Recognising the value of pre-sale services, the KFTC may be reluctant to prevent them, unless less drastic means for generating the same benefits are available.<sup>137</sup> If there is an alternative means of providing the same pro-competitive effect or efficiency, the KFTC should prohibit the vertical restraints. The new vertical guidelines should not then list mere details but give examples. However, the exemplified details should not be binding, but give guidance to competition law practitioners and enterprises not to infringe the law.

Along with these criteria, the new guidelines need to include other factors that may significantly impede competition by vertical restraints. Some vertical restraints with market power can improve inter-brand competition. However, there is still a risk of excessive anti-competitive effects, where the enterprise leverages horizontal or vertical market power through vertical foreclosure, entry barrier, and collusion. These are certainly negative impacts on competition, which the KFTC should be concerned about. Therefore, it is essential for the KFTC to find a marginal scrutiny to create the best policy of competition law. As a practical matter, the KFTC's analysis may often reach the same results as a market power screen, but it should require more sophisticated economic analysis, measuring each restraint's economic effect on competition. Its analysis should focus on inter-brand effects and, specifically, on horizontal effects at either the manufacturer's or the dealer's level. It should not ignore the fact that vertical restraints may also facilitate collusion.<sup>138</sup>

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<sup>135</sup> Frank Easterbrook, *Supra.*, note 77, p. 156; Alan Meese, 'Property Rights and Intra-brand Restraints', *Cornell Law Review*, Vol. 89, 2004, pp. 586-620.

<sup>136</sup> Massimo Motta, *Supra.*, note 7, p. 347.

<sup>137</sup> See Alden Abbott, 'Paradox Regained: Towards a 'New Economic Approach' to Vertical Restraints Policy', *George Washington Law Review*, Vol. 48, 1980, p. 579.

<sup>138</sup> For further discussion about facilitating collusions in both upstream and downstream levels, see Peter Carstenesen, 'The Competitive Dynamics of Distribution Restraints: Efficiency versus Rent Seeking' in Antonio Cucinotta, Roberto Pardolesi, and Roger Van den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, pp. 284-6.

Therefore, the standard in the new guidelines should include all potential anti-competitive aspects of vertical restraints.<sup>139</sup> The KFTC has to be hostile to these practices. The economic justifications for the imposition and maintenance of vertical restraints remain somewhat doubtful. Even if vertical restraints increase additional information and services at the distribution level, the welfare effects of increased services and information are ambiguous, since consumer welfare may rise or fall. These uncertainties, and the possible harmful effects on consumer welfare, raise judicial doubts on vertical restraints, especially in light of the argument of competition scholars that consumer welfare rather than efficiency concerns should guide competition law analysis.<sup>140</sup> In addition, the uncertainty of the national economy raises the same consideration. The new vertical guidelines should include all of these considerations for ensuring the achievement of competition law objectives, and provide criteria for the harmful factors of vertical restraints.

## 6.6. Concluding Remarks

Excessive concerns about economic power have made the KFTC fearful to develop vertical regulation for efficiency and pro-competitiveness improvements. The current provisions from these concerns do not satisfy the objectives of Korean competition law. The overall objectives of competition policy vary from country to country. In particular, objectives other than efficiency are included in many countries. However, these social, economic, and political objectives also vary across countries, and may often conflict with the aim of promoting efficiency.<sup>141</sup> For that reason, it has not been easy for Korean competition policy-makers to establish more efficiency-focussed legislation. The KFTC has not, thus, fully established satisfactory theories of vertical restraints, and demonstrated its unfledged implementation of the law. Furthermore, cases in Korea illustrate that the KFTC and the courts need to develop their rationale to reach the evidentiary argument for vertical restraints. Although the KFTC's decision in some cases was founded on economic theory, it has a long way to go to reach a sufficient level of efficiency-enhancement. The KFTC should bear this

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<sup>139</sup> Kevin Arquit, *Supra.*, note 7, p. 926.

<sup>140</sup> Alden Abbott, *Supra.*, note 137, pp. 582-3.

<sup>141</sup> See Sylvia Ostry, 'Globalization, Domestic Policies and The Need For Harmonization' in Leonard Waverman, William Comanor, and Akira Goto (eds), *Competition Policy in the Global Economy: Modelities For Competition*, Routledge, New York, 1997, p. 34.

burden, since its wrongful decisions may create a significant amount of costs to enterprises. This eventually distorts competition, which leads to a competitor-protection policy.

This chapter has considered a further development of vertical regulation in Korea by the regulatory reform of Articles 3-2, 4, 19, 23, and 29 MRFTA, along with the establishment of new vertical guidelines, which can fit the aims of Korean competition law. Then, the courts need to take a full analysis of vertical restraints. Otherwise, satisfactory outcomes from reform will not be appreciated. The case law development will ensure appropriate competition policy and implementation of the Korean competition law. A sufficient level of economic enquiry into the actual effect of every vertical restraint will overwhelm the judges.<sup>142</sup> However, the suggested reform will subsequently help the courts better understand the effects of vertical restraints, with reference to economic principles. The apparent retreat from strict enforcement by regulatory reform will offer a potential change in examining vertical restraints at the micro and macro level. The next chapter will critically assess new approaches to vertical restraints from the amendments discussed in this chapter, based on the micro and macro analyses.

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<sup>142</sup> George Hay, *Supra.*, note 97, p. 422.

## Chapter 7

# Critical Assessment of Regulatory Reform: Model for Globalisation

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### 7.1. New Vertical Regulation Approach Scrutinised for Small Market

The number of countries adopting competition policy is increasing worldwide,<sup>1</sup> most competition policy in these countries correlating with their trade policy. In particular, the rapid and increasing global market integration through free trade has heightened political tensions between major trading countries, where there are domestic industrial problems as impediments to adjustment of trade.<sup>2</sup> This impacts on national competition policy.<sup>3</sup>

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<sup>1</sup> See Paul Cook, Colin Kirkpatrick, Martin Minogue, and David Parker, 'Competition, Regulation and Regulatory Governance: An Overview' in Paul Cook, Colin Kirkpatrick, Martin Minogue, and David Parker (eds), *Leading Issues in Competition, Regulation, and Development*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2004, pp. 4-5.

<sup>2</sup> For example, international competition has brought fundamental changes in the US industries. See Robert Pitofsky, 'Antitrust at the Turn of the Twenty-First Century: A View from the Middle', *Saint John's Law Review*, Vol. 76, 2002, p. 586.

<sup>3</sup> E.g. the US-Japan Structural Impediments Initiative (SII) talks. A large volume of academic literature regarding this has been published. See Hiroyuki Odagiri, *Growth Through Competition, Competition Through Growth: Strategic Management and the Economy in Japan*, Clarendon Press, Oxford, 1992, pp. 322-4; Frederic Scherer, *Competition Policies for an Integrated World Economy*, The Brookings Institute, Washington D.C., 1994, p. 13; Mitsuo Matsushita, 'The Antimonopoly Law in Japan' in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington D.C., 1997, pp. 155-6; Mark Furse, 'Competition Law and the WTO Report: "Japan – Measures Affecting Consumer Photographic Film and Paper"', *European Competition Law Review*, Vol. 20, No. 1, 1999, pp. 9-13; Russell Weintraub, 'Globalization's Effect on Antitrust Law', *New England Law Review*, Vol. 34, 1999, pp. 32-3; Ulrike Schaeede, *Cooperative Capitalism: Self-Regulation, Trade Associations, and the Antimonopoly Law in Japan*, Oxford University Press, Oxford, 2000, pp. 273-5; Kevin Kennedy, *Competition Law and The World Trade Organisation: The Limits of Multilateralism*, Sweet & Maxwell, London, 2001, pp. 52-5; Toshiaki Takigawa, 'Prospect of Antitrust Law and Policy in 21st Century: In Reference to Japanese Antimonopoly Law and Fair Trade Commission' *Journal of Korean Competition Law*, Vol. 8, 2002, p. 163; Michael Utton, *International Competition Policy: Maintaining Open Markets in the Global Economy*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p. 3; Chris Noonan, *The Emerging Principles of International Competition Law*, Oxford University Press, Oxford, 2008, pp. 22-5; Masako Wakui, *Antimonopoly Law: Competition Law and Policy in Japan*, Arima Publishing, Suffolk, 2008, pp. 30-31.



Competition policies in large economies, in particular, have been a major tool for achieving economic and other social goals, including trade and state economy, for several decades.<sup>4</sup>

In addition, competition policies around the world differ according to the needs and levels of economic development.<sup>5</sup> Korean competition policy differs from large economies in its unique economic development, background, culture, and, especially, market size. Small markets are normally assumed to be characterised by monopolies,<sup>6</sup> and some may argue the Korean market is one of the best examples. Therefore, in Korea, less rigid competition policy for efficiency reasons may not easily take root, for the fear that it may harm competition and international trade.<sup>7</sup> Unlike Korea, competition policies in most small market economy countries have obtained the name of protection of market<sup>8</sup> or domestic firms,<sup>9</sup> which may result in two kinds of costs: (i) monopolistic misallocation of resource, i.e., failure of allocative efficiency; and (ii) disincentives for efficiency from vigorous competition, in other words, failure of productive and dynamic efficiency.<sup>10</sup> These small economies have competition laws for protecting successful firms, especially since the idea of competition has adapted to evolving economics-influences as well as legal and political changes.<sup>11</sup> Their competition law goal seems to appear as a macroeconomic goal, rather than non-economic or social goal. However, the approach of Korean competition enforcement is very different from

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<sup>4</sup> Some may argue that competition policies in large economies do not necessarily apply to small market economies of developing countries such as Korea. For further discussion, see Michal Gal, *Competition Policy for Small Market Economies*, Harvard University Press, MA, USA, 2003, p. 1.

<sup>5</sup> See Mark Furse, 'Competition Law Choice in China', *World Competition*, Vol. 30, No. 2, 2007, p. 326; Dina Waked, 'Competition Law in the Developing World: The Why and How of Adoption and Its Implications for International Competition Law', *Global Antitrust Review*, Issue 1, 2008, p. 69.

<sup>6</sup> Paul Cook et al., *Supra.*, note 1, p. 39.

<sup>7</sup> However, most developing countries seem to take the advantages of national large firms and to easily justify monopolistic or oligopolistic structures. See Pradeep Mehta, Manish Agarwal, and V.V. Singh, *Politics Trumps Economics: Lessons and Experiences on Competition and Regulatory Regimes from Developing Countries*, UNCTD, May, 2007, p. 15: [http://www.unctad.org/sections/wcmu/docs/c2clp\\_ige8p11Cuts\\_en.pdf](http://www.unctad.org/sections/wcmu/docs/c2clp_ige8p11Cuts_en.pdf) (accessed 23 August 2008).

<sup>8</sup> E.g., *Keiretsu* has been considered as one of mechanisms of trade protection. See Gary Saxonhouse, 'What Does Japanese Trade Structure Tell Us About Japanese Trade Policy?', *The Journal of Economic Perspectives*, Vol. 7, No. 3, 1993, pp. 35-9; Frederic Scherer, 'Retail Distribution Channel Barriers to International Trade', *Antitrust Law Journal*, Vol. 67, 1999, p. 77.

<sup>9</sup> Even some argue that the goals of the US antitrust enforcement sometimes demand protection of competitors. See Louis Schwartz, '"Justice" and Other Non-Economic Goals of Antitrust', *University of Pennsylvania Law Review*, Vol. 127, 1979, p. 1076.

<sup>10</sup> Some firms are also likely to seek governmental protection from effective competition, which results in protectionism as rent seeking. See William Baumol and Janusz Ordover, 'Use of Antitrust to Subvert Competition', *Journal of Law and Economics*, Vol. 28, No. 2, 1985, pp. 248-50.

<sup>11</sup> A good example of political influence can be seen in the US politics and Chicago School, see Lawrence Sullivan and Warren Grimes, *The Law of Antitrust: An Integrated Handbook*, 2nd edn, Thomson West, St. Paul MINN, USA, 2006, p. 7; Steven Teles, *The Rise of the Conservative Legal Movements: The Battle for Control of the Law*, Princeton University Press, Princeton NJ and Oxford, 2008, Chapters 4 and 6.

this protection strategy. The Korea Fair Trade Commission (KFTC) rather, applies a strict rule, as discussed in previous chapters, focusing on non-economic goals, such as redistribution of wealth or consumer welfare improvement.

Competition policy is essential when countries with economies in transition restructure their domestic economies, and integrate them into the global economy. Therefore, countries such as Korea should develop competition law to become competitive in a globalised economy,<sup>12</sup> through eliminating public and private restraints to trade.<sup>13</sup> Korea is a good example of using economic growth and competition policy to vigorously join the international market. Under these circumstances, efficiency outcomes from vertical restraints should be regarded as practical. Firms make vertical arrangements of various types in order to reduce transaction costs, guarantee stability of supplies, and have better contracts.<sup>14</sup> These practices cannot harm free trade if the domestic market is open to foreign firms without discriminatory competition law provisions. Nevertheless, the KFTC has not fully considered the effects from open market economies.

It is proper that when a small economy opens to the global economy, its competition authority needs to consider hindrances caused by the anti-competitive behaviour of private enterprises to market access,<sup>15</sup> especially vertical restraints. Competition law should, then, generally guarantee that domestic large firms would be unable to restrict market access.<sup>16</sup> This concern can rise in an increasingly integrated and liberalised global economy.<sup>17</sup> Some may argue that vertical restraints can have the effect of preventing foreign enterprises from developing a distribution network. Moreover, entry barriers may occur in the case of domestic dominant enterprises that engage in abusive practices. This is designed with the aim

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<sup>12</sup> See Maher Debbah, *The Internationalisation of Antitrust Policy*, Cambridge University Press, New York, 2003, pp. 47-8. Traditionally, trade law has involved public restraints of trade, and competition law has concerns about private restraints. Trade law is internationally oriented whereas competition law has national grounds.

<sup>13</sup> See Eleanor Fox, 'Toward World Antitrust and Market Access', *American Journal of International Law*, Vol. 91, 1997, p. 3.

<sup>14</sup> See Massimo Motta, *Competition Policy: Theory and Practice*, Cambridge University Press, Cambridge, 2004, p. 302.

<sup>15</sup> See Avinash Dixit, 'Issues of Strategic Trade Policy for Small Countries', *The Scandinavian Journal of Economics*, Vol. 89, No. 3, 1987, pp. 350-57; Eleanor Fox, *Supra.*, note 13, p. 1; Frederic Scherer, *Supra.*, note 8, p. 77.

<sup>16</sup> See Christian Conrad, 'Strategies to Reform the Regulations on International Competition', *World Competition*, Vol. 26, No. 1, 2003, p. 111.

<sup>17</sup> Maher Debbah, *Supra.*, note 12, Chapter 8.

of excluding foreign enterprises from domestic markets.<sup>18</sup> Sometimes, although foreign rivals can have more difficulty penetrating a new market than domestic firms,<sup>19</sup> domestic competition authorities give excessive exemptions to domestic dominant firms. In that case, countries with competition law may exempt the anti-competitive behaviour of domestic enterprises, and this can be problematic when it impedes international trade.<sup>20</sup> Furthermore, domestic firms may have a stronger incentive to re-erect barriers and keep their advantages in the domestic market. In particular, when a distribution channel is limited, competition policy has an important role in ensuring that foreign firms have the same access to domestic channels as do domestic firms. Thus, Korean competition policy cannot entirely be separated and distinguished from trade policy.<sup>21</sup>

According to this argument, the best method for removing private barriers to market access is through vigorous application of national competition laws.<sup>22</sup> Since free international trade of small economies is very important for economic growth, the concern about exemption may increase.<sup>23</sup> However, if the exemption on vertical restraints is not discriminatory against foreign enterprises, and the domestic market is open without any public restraints such as high tariffs, it should be considered a vital means of improving competition and efficiency. The amendments to vertical regulation stated in the previous chapter are not discriminatory against foreign firms, and will thus eventually improve competition in the long run. In this chapter, the primary question will be whether the suggested amendments in Chapter 6 will cause further vertical foreclosure, as a method of fostering private restraints, which will impede international trade and competition. For instance, some may question that if there is a significant uncertainty of supply in international transactions, the demands of vertical restraints, such as exclusive dealing, may increase.<sup>24</sup>

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<sup>18</sup> *Ibid.*, pp. 209-10.

<sup>19</sup> Chris Noonan, *Supra.*, note 3, p. 112.

<sup>20</sup> See Sylvia Ostry, 'Globalization, Domestic Policies and The Need For Harmonization' in Leonard Waverman, William Comanor, and Akira Goto (eds), *Competition Policy in the Global Economy: Modalities For Competition*, Routledge, New York, 1997, p. 29.

<sup>21</sup> See William Comanor and Patrick Rey, 'Competition Policy Towards Vertical Foreclosure in A Global Economy' in Leonard Waverman, William Comanor and Akira Goto (eds), *Competition Policy in The Global Economy: Modalities for Cooperation*, Routledge, London and New York, 1997, p. 356; Michal Gal, *Supra.*, note 4, p. 41.

<sup>22</sup> Kevin Kennedy, *Supra.*, note 3, p. 1.

<sup>23</sup> See Eleanor Fox, 'Economic Development, Poverty and Antitrust: The Other Path', *Southwestern Journal of Law and Trade in the Americas*, Vol. 13, 2007, pp. 212-4.

<sup>24</sup> See Kenneth Arrow, 'Vertical Integration and Communication', *The Bell Journal of Economics*, Vol. 6, No. 1, 1975, p. 173.

This practice may ultimately result in anti-competitive outcomes in the Korean market. As argued above, this problem cannot emerge unless competition law is discriminatory against foreign firms.

The KFTC sometimes seems to believe that aggressive competitors can impede competition by injuring their rivals. It underlies a range of competition law controlling vertical restraints, although most vertical restraints may be means of pro-competition, operating more efficiently.<sup>25</sup> The incumbent *Chaebol* may be able to impede market entry,<sup>26</sup> but its complete control in the market may become increasingly difficult, through the erosion of entry barriers. Unless entry is completely blocked, market shares will be gradually eroded. In other words, it is possible that the market structure may change, as a result of the growth of imports.<sup>27</sup> In addition, current competition law established discriminatory measures against domestic large firms through controlling domestic holding companies' internal transactions, which is sufficient to curb their market power. If the law discriminates against domestic enterprises to prevent market concentration, the domestic market will be harmed by foreign monopolists in the long run. Besides, in strategic trade environments, many suggest that proper design of competition policy must reflect not only the consequences of the policy on domestic consumers, but also on the relative competitiveness of domestic firms in a global struggle for market leadership and profits.<sup>28</sup> In short, the Korean competition law should maximise efficiencies rather than focusing on consumer welfare, because this is myopic.

The regulatory reform in the previous chapter will prevent anti-competitive vertical arrangements, which may inhibit competition, by examining the degree of market power held by a firm. It will also trigger vigorous competition in the domestic market. This will balance anti-competitive effects and efficiency outcomes, which will not harm macroeconomic policy, i.e., international trade. Some argue that vertical restraints create more significant harm to

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<sup>25</sup> See Robert Bork, 'Contrasts in Antitrust Theory: I', *Columbia Law Review*, Vol. 65, No. 3, 1965, p. 402.

<sup>26</sup> See Ho Young Lee, *Dok-Jum-Kyu-Jae-Bub-Ui-Ie-Ron-Kwa-Sil-Mu [Theories and Practices in Monopoly Regulation and Fair Trade Act]*, Hongmunsa, Seoul, 2006, pp. 114-5. The author argues that the monopolised market structure by *Chaebols*' affiliates creates a blockage against potential entrants.

<sup>27</sup> See Michael Utton and A.D. Morgan, *Concentration and Foreign Trade*, Cambridge University Press, Cambridge, 1983, p. 51; Michael Utton, *Profits and Stability of Monopoly*, Cambridge University Press, Cambridge, 1986, p. 3. The KFTC provides guidelines to improve imports and also prevents anti-competitive practices which inhibit trade flows, e.g., Notification on the Types of and Criteria for Determining Unfair Business Practices in International Contracts, KFTC Notification No. 1997-23, Apr. 21, 1997; The Types of Unfair Trade Conducts Regarding Parallel Import, KFTC Notification No. 1998-18 amended on Dec. 31, 1998.

<sup>28</sup> See Janusz Ordover, 'Transnational Antitrust and Economics' in Barry Hawk (ed), *Antitrust and Trade Policy in International Trade*, Matthew Bender, New York, 1985, pp. 234-5.

competition in smaller markets than in large ones. It is therefore often discussed that the US rule of reason in vertical cases makes sense only in the context of such a large market.<sup>29</sup> However, this is wrong. Each competition regime develops rule of reason or objective justification<sup>30</sup> regardless of whether its market size, where it finds benefits from balance tests. Sometimes the KFTC seems reluctant to adopt the full rule of reason, on the grounds that the US rule of reason may work only in the common law system.<sup>31</sup> This approach brings concerns not only to large domestic firms, but also foreign firms who have or will have businesses in the Korean market. Recent cases such as *Microsoft*<sup>32</sup> and *Intel*<sup>33</sup> demonstrate this. As cases of foreign firms increase in Korean jurisdiction, the demands for establishment of more globalised vertical regulation increases.<sup>34</sup> This is crucial to establish a globalised standard in Korean competition law.<sup>35</sup> This chapter, thus, intends to assess the suggested amendments regarding domestic competition, and then discuss those regarding global perspectives.

## 7.2. Micro-Assessments on the New Vertical Regulation

### 7.2.1. Provisions on Abuse of Market Dominant Position

The market power proof requirement in vertical cases generally requires the application of an economic approach, because economic analysis indicates that, if there is no significant

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<sup>29</sup> See David Gerber, 'Competition Law', *The American Journal of Comparative Law*, Vol. 50, 2002, pp. 284-5.

<sup>30</sup> For further discussion about objective justification in the EC regime, see Paul-John Loewenthal, 'The Defence of "Objective Justification" in the Application of Article 82 EC', *World Competition*, Vol. 28, No. 4, 2005, pp. 455-77. The EC objective justification cannot be seen as 'an exemption' to abusive practices, e.g., Case 62/86, *Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v Zentrale zur Bekämpfung Unlauteren Wettbewerbs eV* [1989] ECR 803, [1990] 4 CMLR 102.

<sup>31</sup> See Bong Eui Lee, 'Bul-Gong-Jung-Go-Rae-Haeng-Wi-Ui-Wi-Bub-Sung (Illegality in Unfair Business Practices)' in Ohseung Kwon (ed), *Gong-Jung-Go-Rae-Wa-Bub-Chi [Fair Trade and Regulation]*, Bubmunsa, Seoul, 2004, p. 682.

<sup>32</sup> *Microsoft Co.*, KFTC Decision 2006-042, 2002Kyoungchok0452 and 2005Kyoungchok0375, Feb. 24, 2006.

<sup>33</sup> *Intel Corp., Intel Semiconductor Ltd, and Intel Korea*, KFTC Decision 2008-295, 2007Dokgam1790 and 2008Sijang1126, Nov. 5, 2008.

<sup>34</sup> See Seung-Wha Chang, 'Violation Criteria of Tying under the Monopoly Regulation and Fair Trade Act', *Seoul University Law Journal*, Vol. 45, No. 4, 2004, p. 517. The author argues that the simplified decision without theoretical background in such tie-ins in new economy should not be made because of the impact of global aspect.

<sup>35</sup> See Hun-Jae Suh, 'Globalisation of the Korean Competition Law' *The Justice*, Vol. 92, 2006, p. 259.

market power, anti-competitive effects from vertical practices do not exist.<sup>36</sup> In particular, Article 3-2 MRFTA has been regarded as one of the core engines bringing sound market order in the Korean market. Although this statutory provision is added to prevent further market dominance, the KFTC has applied this measure less often than Article 23. This indicates that the KFTC has the burden of proof of abusive conduct based on its vague definition of unfairness. However, the suggested reform of dominance presumption under Article 4 will lessen administrative costs of investigation. In other words, the reform adopts quasi-per se illegality for anti-competitive unilateral acts at the horizontal level based on market power, but also accepts the rule of reason for vertical restraints. Then, the proposed market share threshold test can be appropriate, since it can also offer enterprises benefits of block exemption, where they do not exercise real market power at the vertical level.<sup>37</sup>

The only technical difficulty in the presumption of market dominance is to define the relevant market.<sup>38</sup> Defining the market is very important, because the burden of proof in defining the market can influence a successful analysis of an application of the market share test. Although this problem still remains, the provision of market share threshold gives legal certainty to enterprises practising restraints in the market, which will improve consistency in the KFTC's enforcement. Furthermore, the KFTC and lawyers have developed their techniques of market definition in merger cases. Therefore, the administrative burden of the market share test will be gradually reduced. The existing problem is whether the present presumption in the test of market dominance is appropriate. The current KFTC implementation shows that it does not apply appropriate rules, because of the wrongful standard of Concentration Ratio (CR) 3 under Article 4. For example, in the *Interpark* case,<sup>39</sup> the KFTC applied Article 3-2 based on CR3 test, although the firm's market share, 40 per cent, could not have been presumed market dominance. On the contrary, the KFTC applied Article 23 in *Namyang* and *Maeil*<sup>40</sup> although their market shares satisfied the dominance

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<sup>36</sup> See Louis Kaplow, 'Antitrust, Law and Economics, and the Courts', *Law and Contemporary Problems*, Vol. 50, No. 4, 1987, p. 196.

<sup>37</sup> For further discussion, see Einer Elhauge, 'Defining Better Monopolization Standards', *Stanford Law Review*, Vol. 56, No. 2, 2003, pp. 334-7.

<sup>38</sup> See Philip Areeda, 'Monopolization, Mergers, and Markets: A Century Past and the Future' *California Law Review*, Vol. 75, No. 3, 1987, p. 979. The author states that there are some difficulties in market power assessments: (i) the data on market definition is often incomplete; and (ii) market share is an imperfect for measuring market power.

<sup>39</sup> *Interpark G Market Corp.*, KFTC Decision 2007-555, 2006Sukyoung4846, Dec. 18, 2007.

<sup>40</sup> *Namyang Diary* and *Maeil Diary*, KFTC Decision 2007-345, 2006Dokgam4792 and 4818, July 3, 2007. This was a joint decision of the KFTC.

presumption of CR3 (78 per cent). The suggested presumption in the test of market dominance will solve this unclear border between applications of Articles 3-2 and 23. This guidance gives sufficient notice for enterprises to prevent abusing their market power.

Article 19 MRFTA will then remain as a major device forming a framework for the trade-off between anti- and pro-competitive effects in vertical agreements, and Articles 3-2 and 23 will be the measures to prevent unilateral restraints. Along with Article 19, Articles 3-2 and 23 will prevent abusive practices, and at the same time allow economic efficiency in vertical arrangements. In other words, efficiency consideration cannot be excluded from the analysis carried out under Articles 3-2 and 23, as well as Article 19,<sup>41</sup> since the unilateral case will be scrutinised under the rule of reason. In reality, the distinction between Articles 3-2 and 19 is not easy in vertical cases. However, the suggested reform of presumption of market dominance under Article 4, and safe harbour in the vertical guidelines, will subsequently reduce administrative burdens, and increase gains from the efficiency justification, as well as legal certainty.<sup>42</sup> This will guide the courts to further develop details of criteria to offer distinctions between unilateral and concerted practices.

The existing Article 3-2 analysis is the provision by which the KFTC and the courts barely implement an economic theory of efficiency, because of the MRFTA's unique development, by curbing *Chaebols*. Although case law in Korea is a very important source of application of the law, and also has the same important value for judicial development as the US and the EC,<sup>43</sup> it has not been developed as much as other competition regimes. The major problem comes from the fact that the KFTC and the courts tend to apply the per se rule to various forms of vertical practices, such as Resale Price Maintenance (RPM), or practices by

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<sup>41</sup> Some scholars argue Art. 82 EC enforcement should also consider efficiency. See Damien Geradin, 'Efficiency Claims in EC Competition Law and Sector-Specific Regulation' in Hanns Ullrich (ed), *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p.346.

<sup>42</sup> However, some argue that market share alone can mislead the test. See William Landes and Richard Posner, 'Market Power in Antitrust Cases', *Harvard Law Review*, Vol. 94, No. 5, 1981, pp. 947-51. Furthermore, there are some commentators arguing that the EC vertical regulation does not give legal certainty and notification method is more plausible. However, There is no concrete outcome which is supportive to this argument and moreover, this problem is probably caused from decentralisation which the Korean regime is not concerned about. For further discussion, see David Roitman, 'Legal Uncertainty for Vertical Distribution Agreements: the Block Exemption Regulation 2790/1999 (BER) and Related Aspects of the New Regulation 1/2003', *European Competition Law Review*, Vol. 27, No. 5, 2006, pp. 261-8.

<sup>43</sup> See Einer Elhauge and Damien Geradin, *Global Competition Law and Economics*, Hart Publishing, Oxford and Portland Oregon, USA, 2007, p. 38.

large firms, although the current *POSCO* judgment<sup>44</sup> changed this. However, the per se prohibition of certain types of vertical conduct should be justified, because such conduct may have welfare-enhancing effects.<sup>45</sup> Therefore, it is for the KFTC to examine vertical restraints by a more tolerant competition policy. This is because loss of market dominance by domestic firms can be ignored where the market is open to foreign companies. Furthermore, domestic monopolists may be more ‘self-destructive’<sup>46</sup> under free international trade, because monopoly prices in a single domestic market eventually attract foreign firms which are larger than domestic ones. Accordingly, an important source of the decline in domestic market concentration is the increase of imports.<sup>47</sup> Therefore, the amendment to Article 4 MRFTA regarding presumption of market dominance and the application of Article 3-2 will produce beneficial outcomes of concrete measures for preventing abuse of market dominance, whilst allowing efficiency results. This system will give clearer guidance for the application of abuse of market dominance rule.

Some may further question the 30 per cent market share threshold test, the idea borrowed from EC vertical regulation, and whether this should be implemented in Article 3-2 or 23 cases. In the EC, 30 per cent block exemption is applicable only to the agreements. Accordingly, the application of block exemption only in Article 81 EC cases has brought some questions whether this exemption can be also applicable in Article 82 cases. In *Tetra Pak*,<sup>48</sup> nevertheless, the Court of First Instance (CFI) confirmed that Article 82 EC does not allow for any Article 81(3) type exemption. Some argue that, however, even when the EC Commission applies Article 81 EC, it relies on a substantive analysis of market power in its market share threshold test, although certain agreements, such as minimum RPM and absolute territorial restrictions, are unlawful without further market power tests.<sup>49</sup> This may confuse application of the law, since the EC applies a market share test for block exemption only in Article 81 EC cases, although the EC competition authorities examine market power in both Articles 81 and 82 cases.

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<sup>44</sup> *POSCO v. KFTC*, Supreme Court, 2002Du8626, Nov. 22, 2007.

<sup>45</sup> For instance, the KFTC has not fully considered theoretical arguments of welfare effects by the Chicago or Post-Chicago Schools in the current tying cases. For further comparison with the US, see ABA, *Antitrust Law and Economics of Product Distribution*, ABA Publishing, Chicago, 2006, pp. 190-91.

<sup>46</sup> For discussion about self-destruction of large firms, see Frank Easterbrook, ‘The Limit of Antitrust’, *Texas Law Review*, Vol. 63, 1984, p. 2.

<sup>47</sup> Michael Utton, *Supra.*, note 27, p. 58.

<sup>48</sup> Case T-51/89, *Tetra Pak Rausing SA v Commission*, [1990] ECR-II 309, [1991] 4 CMLR 334.

<sup>49</sup> See Giorgio Monti, *EC Competition Law*, Cambridge University Press, Cambridge, 2007, pp. 153-7.



One may argue that this will trigger the same argument in the new Korean vertical regulation, where the KFTC adopts a block exemption technique from the EC regime. However, the MRFTA's implementation system is very different from that of the EC. Article 4, which the EC does not have, already provides market share presumption for the test in Article 3-2 cases. In addition, Article 23, as a supplementary provision, is applied to overall anti-competitive or unfair practices, without Article 4 guidance. Therefore, the amendment to Article 4 will ensure application of Article 3-2, and the vertical guidelines of 30 per cent market share threshold will help the KFTC apply a proper provision, whether Article 3-2 or 23. Furthermore, there is no market integration concern in Korea, unlike the EC. Therefore, there will be fewer problems in the balance test based on market share provision in Article 3-2 cases than Article 82 EC. Moreover, Articles 19 and 23's application based on the designed block exemption provision improves legal certainty. In conclusion, the 30 per cent market share threshold, along with the suggested Article 4 MRFTA, can be effectively applicable to abuse of dominance cases under Article 3-2, and also concerted cases under Article 19.

#### 7.2.2. Provisions on Unfair Concerted Agreements: Market Share Threshold

To examine the amendment to Article 19 MRFTA, it is necessary to scrutinise the existing rules in the EC, and whether they may work in Korea, because the market share threshold test is the core of change. Some commentators maintain that the threshold test of 30 per cent market share in the EC was the expected outcome.<sup>50</sup> It might, however, be an open question whether this system introduced by the EC Commission is likely to be considered excessively generous,<sup>51</sup> according to the economics-based approach.<sup>52</sup> Therefore, the KFTC has to consider the following problem; whether the market share criterion in new vertical guidelines is necessarily arbitrary to a certain extent, because of its random choice of 30 per cent market share, simply based on administrative convenience, and also if it is unnecessarily generous.

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<sup>50</sup> See Richard Whish, 'Regulation 2790/99: The Commission's "New Style" Block Exemption for Vertical Agreements' *Common Market Law Review*, Vol. 37, 2000, p. 888.

<sup>51</sup> See Wulf-Henning Roth, 'Strategic Competition Policy: A Comment on EU Competition Policy' in Hanns Ullrich (ed), *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p. 46.

<sup>52</sup> See Maurizio Gambardella and Francesco Maria Salerno, 'Vertical Agreements: Was the Commission's Response Adequate? On the Commission's Ability to Reform Long-standing Policies' in Giuliano Amato and Claus-Dieter Ehlermann (eds), *EC Competition Law: A Critical Assessment*, Hart Publishing, Oxford, 2007, p. 176.

Some commentators propose withdrawal of 30 per cent market share threshold in the EC, because sometimes vertical agreements can appear to deserve investigation even below the 30 per cent threshold.<sup>53</sup> Furthermore, policy-makers often attempt to simplify legal provisions, in order to mitigate competition lawyers' concerns for legal certainty. These rules may not work in reality. However, the benefits from safe harbour are more appreciated than incurred costs. Under the EC vertical regulation, growing use of market shares creates this benefit, hence providing presumptions of legality to certain vertical restraints. It is still remarkable that this expansion of the market share approach is accompanied by other indicators for determining market power such as entry barriers and financial strength in favour of a more economics-based approach.<sup>54</sup>

Economic analysis based on market share threshold provides more objective standards for the KFTC and the courts, and also larger predictability for domestic and foreign enterprises in the Korean market.<sup>55</sup> This outcome becomes imperative, since simple per se rules on such as minimum RPM may inhibit competition in the market.<sup>56</sup> Therefore, as analysed by the studies on EC vertical regulation, the major advantage from the market share test in examining vertical agreements is to remove the burden for enterprises above the threshold to carry out a complex assessment of their vertical agreements. It is, then, more likely that competition lawyers will have the means or legal techniques to undertake the case adequately, thereby reducing the risk of extended, costly and uncertain litigation.<sup>57</sup> Although the adoption of the 30 per cent market share threshold test cannot escape charges of having set an arbitrary threshold, it still gives the benefit of legal certainty. In addition, if a vertical

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<sup>53</sup> See Denis Waelbroeck, 'Vertical Agreements: 4 Years of Liberalisation by Regulation N. 2790/99 After 40 Years of Legal (Block) Regulation' in Hanns Ullrich (ed), *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, pp. 87-90.

<sup>54</sup> See Barry Hawk and Nathalie Denaeyer, 'The Development of Article 81 and 82 EC Treaty: Legal Certainty' Working Paper in Claus-Dieter Ehlermann and Isabela Atanasiu (eds), *European Competition Law Annual 2000: The Modernisation of EC Antitrust Policy*, Hart Publishing, Oxford and Portland Oregon, USA, 2001, p. 129; Roger Van den Bergh, 'The Difficult Reception of Economic Analysis in European Competition Law' in Antonio Cucinotta, Roberto Pardolesi, and Roger Van den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, pp. 46-7.

<sup>55</sup> Hun-Jae Suh, *Supra.*, note 35, p. 273. The author argues that economic analysis is very crucial to improve the MRFTA for a global standard.

<sup>56</sup> Per se rule can be considered as simple because of its reduction of litigation costs. See William Bohling, 'A Simplified Rule of Reason for Vertical Restraints: Integrating Social Goals, Economic Analysis, and Sylvania', *Iowa Law Review*, Vol. 64, 1979, p. 490; Andrew Gavil, 'Competition Policy, Economics, and Economists: Are We Expecting Too Much?' in Barry Hawk (ed), *International Antitrust Law and Policy: Fordham Competition Law 2006*, Juris Publishing, Huntington NY, USA, 2006, p. 589.

<sup>57</sup> Denis Waelbroeck, *Supra.*, note 53, 2006, p. 88-91.

agreement is deemed to deserve investigation even below the 30 per cent threshold, the KFTC can still catch the anti-competitive practice by applying Article 23.

In addition, the Guidelines for the review cartel (Cartel Guidelines)<sup>58</sup> provide an exemption condition of 20 per cent market share threshold, except for hard-core restrictions such as price fixing, or output restriction in horizontal concerted practices. Accordingly, the KFTC can have a more relaxed block exemption provision for vertical agreements than horizontal agreements, and thus, 30 per cent market share threshold is not exceptionally lenient. Furthermore, as held in the EC, this block exemption will reduce the administrative burden of competition authority,<sup>59</sup> and overwhelming burdens on judges. In fact, the per se rule is a generalisation, but the rule of reason, which the KFTC and the courts have been developing, is rather a case-by-case approach.<sup>60</sup> Since a case-by-case investigation is not always practicable in the civil law system, for the litigation and administrative costs, the KFTC should seek to make better generalisations for certain types of vertical practices, by providing rules both to give legal certainty to firms, and to relieve the courts of the burden of analysing every individual vertical agreement.<sup>61</sup> Therefore, the market share threshold for Article 19 enforcement will support the rule of reason practice of the courts.<sup>62</sup>

Furthermore, the RPM policy change under the amendment will be one of the major improvements. A policy towards RPM is currently somewhat inconsistent worldwide. For example, minimum RPM is treated as per se illegal in the EC, but is tolerated under the rule of reason in the US. The arguments for permitting RPM should be economic, but the KFTC's current legal test for RPM was not based on any economic analysis. Moreover, the tolerance

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<sup>58</sup> Sec. III.2. of the KFTC Guidelines for review cartel, amended on Dec. 21, 2007. The KFTC also tests a balance of outcomes between efficiency and anti-competitiveness, according to sec. III.4. This provision gives a rationale of choice of 30 per cent market share threshold for vertical cases. Furthermore, there will be no such complicated problem of choice of number in market share threshold from the tension between Member States in the EC. See David Cowan and Julie Nazerali, 'Reforming E.U. Distribution Rules – Has the Commission Found Vertical Reality?', *European Competition Law Review*, Vol. 20, No. 3, 1999, pp. 161-3.

<sup>59</sup> See Rosa Greaves, *EC Block Exemption Regulations*, Chancery Law Publishing, Chichester and Springs CO, USA, 1994, p. 4.

<sup>60</sup> See Malcolm Coate and Andrew Kleit, 'Introduction: The Economics of the Antitrust Process' in Malcolm Coate and Andrew Kleit (eds), *The Economics of the Antitrust Process*, Kluwer Academic Publishers, Norwell MA, USA, 1996, p. 2.

<sup>61</sup> This is the same benefit expected as discussed in the EC. See also Joanna Goyder, *EU Distribution Law*, 4th edn, Hart Publishing, Oxford and Portland Oregon, USA, 2005, p. 67.

<sup>62</sup> For further discussion about per se and rule of reason concerning administrative costs and also legal certainty, see Richard Posner, 'The Next Step in the Antitrust Treatment of Restrictive Distribution: Per Se Legality' *The University of Chicago Law Review*, Vol. 48, No. 1, 1981, pp. 7-8.

towards RPM is based on a notion of agreement, which should be covered by Article 19. In light of these contradictions, RPM policy change in MRFTA enforcement is inevitable. However, this change requires a clear understanding and analysis of balance. The balance test should be attached to the anti-competitive and efficiency explanations, since this can be used by enterprises seeking to inhibit competition in order to obtain or to retain monopoly power. This results in harming consumer.<sup>63</sup> The most important factor to decide whether RPM is lawful should be judged by economic theories of balance and trade-off tests, and under Article 19 rather than Article 29.

The KFTC and the courts need to give up their rigid approach to RPM without an economics principle. In *Seragem Medical Device Corp.*,<sup>64</sup> the Seoul High Court upheld the KFTC's decision on the firm's infringement of Article 29 MRFTA. The Court considered the benefits of pro-competitive effects, including pre-sale services by the RPM. However, it concluded that its practice would prevent competition, based on the argument of anti-competitive outcomes and consumer harm. This judgment was wrong, since the relevant product, a personal heating device, generally required pre-sale service, and this would help consumers' choice, thereby improving consumer welfare as well as inter-brand competition. The KFTC and the courts should consider that RPM can benefit not only manufacturers but the efficient functioning of the distribution system generally, including consumer benefits,<sup>65</sup> whilst retaining caution about minimum RPM with market power held by large firms.

Moreover, the persistence of the per se rule forbidding minimum RPM is inconsistent with the judicial approach to vertical non-price restraints.<sup>66</sup> Vertical non-price restraints in Korea are normally subject to a rule of reason. There is no reason why the KFTC and the courts should not take the further step of rule of reason on minimum RPM cases, especially where the trading country has relaxed rules on this.<sup>67</sup> Although the effects of vertical price

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<sup>63</sup> See Howard Marvel, 'The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom', *Antitrust Law Journal*, Vol. 63, 1994, pp. 81-2.

<sup>64</sup> *Seragem Medical Device Corp. v. KFTC*, Seoul High Court 2003Nu7455, Mar. 31, 2004.

<sup>65</sup> See Mark Anderson, 'Vertical Agreements under Section 1 of the Sherman Act: Results in Search of Reason', *University of Florida Law Review*, Vol. 37, No. 5, 1985, p. 913; Howard Marvel, *Supra.*, note 63, p.92.

<sup>66</sup> Richard Posner, *Supra.*, note 62, p. 8.

<sup>67</sup> See Frank Mathewson and Ralph Winter, 'The Economics of Vertical Restraints in Distribution' in Joseph Stiglitz and Frank Mathewson (eds), *New Developments in the Analysis of Market Structure*, MacMillan Press, Hampshire and London, 1986, p. 219. Where the relaxed policy is encouraged in one country such as the US, a trading partner's stricter rules can create disadvantage to the domestic enterprise. Some scholars argue that the

and non-price restraints are not absolutely identical, there is a common issue of concern and efficiency argument in effects. Therefore, all vertical restraints are presumptively pro-competitive. Applying the rule of reason under Article 19 to both vertical non-price and price agreements will largely eliminate excessive concerns about whether the vertical restraint is about price or not.<sup>68</sup> In conclusion, as the volume of international transaction increases, the KFTC should consider a safe harbour method in the new vertical guidelines, for better scrutiny of vertical agreements, including RPM. The safe harbour technique will eventually ensure pro-competitive gains. This will remove the burden of administrative costs, and improve legal certainty, with the rule of reason development.

### 7.3. Macro-Assessments: International Trade, Market Access, and New Regulation

#### 7.3.1. Mutual Interaction and Problems in Strategic Competition Law Legislation

Competition policy can cover wide social and economic issues. This makes the implementation of competition law and policy a more complicated balancing measure in developing countries. To be effective, competition law in developing countries, including Korea, will require amendments and improvements in light of market development and evolution, as is the case in developed countries.<sup>69</sup> Accordingly, the KFTC should be concerned about the importance of vertical regulation in the perspective of a global level, in order to achieve the goals of efficiency gains and free competition from international trade.<sup>70</sup> The modernisation of Korean vertical regulation for a globalised market may eventually lead the KFTC and the courts close to current US and EC concepts of competition and economics, by learning from their legal techniques.<sup>71</sup>

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EC regime should also give up per se ban on RPM. See Femi Alese, 'Unmasking the Masquerade of Vertical Price Fixing', *European Competition Law Review*, 2007, Vol. 28, No. 9, pp. 525-6.

<sup>68</sup> This will be achieved such as in the US regime. See Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution*, Harvard University Press, Cambridge MA, USA and London, 2005, pp. 190-91.

<sup>69</sup> See UNCTD, *The Relationship Between Competition, Competitiveness, and Development*, TD/B/COM.2/CLP/30, 23 May 2002, pp. 11-2: <http://www.unctad.org/en/docs/c2clp30.en.pdf> (accessed 23 August 2008).

<sup>70</sup> See Jungwon Song, *Ca-Ru-Tel-Mit-Bul-Gong-Jung-Go-Rae-Hang-Wi-Kyu-Jae [Regulations on Cartels and Unfair Business Practices]*, Pakyoungsa, Seoul, 2005, pp. 216-7. The author argues the current UBP Guidelines were made by considering for the global standard which can give more pro-competitive intense. However, this can be further developed by the new vertical guidelines.

<sup>71</sup> See Clifford Jones, 'Foundations of Competition Policy in the EU and USA: Conflict, Convergence and Beyond' in Hanns Ullrich (ed), *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p. 37. The author argues that

In particular, adoption of competition laws and policies of US and EC on vertical restraints gives benefits to Korea, such as the following: (i) easy adoption of tried and tested law that is frequently updated; (ii) reduction of trade obstacles; and (iii) reduction of experimental or adaptation costs.<sup>72</sup> The significant contribution of a comparative study based on economics will guide the formation of Korean competition policy.<sup>73</sup> This will lead Korean competition policy closer to globalised competition law, with similar aims of being market-friendly, with less entry barriers. Therefore, the new Korean vertical regulation, which is the outcome of mutual learning from experimental development in the US and the EC, will be more pro-competitive and efficiency-improving, rather than a means for vertical foreclosure or entry barriers, since it is not discriminatory against foreign firms. Some commentators argue that countries may indirectly and strategically apply their vertical regulations in order to promote national businesses at the expense of foreign enterprises. In particular, national and international developments have made aggressive degrees of competition enforcement politically impracticable.<sup>74</sup>

When major domestic industries lose ground in competition with foreign rivals, competition enforcement easily focuses on the efficiency of domestic firms, and treats it as a priority in crafting competition policy.<sup>75</sup> If this happens, a leading national company sometimes may not have much incentive to operate efficiently, or to act in the interests of consumers, unless it is exposed to vigorous competition, either from local or foreign rivals.<sup>76</sup> Although there are no comprehensive empirical data which can clarify this concern, recognition is increasing that the effect of private anti-competitive practices on trade between

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the EC regime will modernise its competition law close to the US although this has yet to be confirmed. Likewise, Korea will take the similar step close to the US and the EC.

<sup>72</sup> See Michal Gal, 'Size Does Matter: The Effects of Market Size on Optimal Competition Policy', *Southern California Law Review*, Vol. 74, 2001, pp. 1438-9; Michal Gal, 'Market Conditions under the Magnifying Glass: The Effects of Market Size on Optimal Competition Policy', *The American Journal of Comparative Law*, Vol. 50, No. 2, 2002, p. 303.

<sup>73</sup> See William Kovacic and Carl Shapiro, 'Antitrust Policy: A Century of Economic and Legal Thinking', *The Journal of Economic Perspectives*, Vol. 14, No. 1, 2000, pp. 58-9. The authors argue that economists have contributed to formulate the US antitrust policy.

<sup>74</sup> See Robert Pitofsky, 'Antitrust in the Next 100 Years', *California Law Review*, Vol. 75, No. 3, 1987, p. 821.

<sup>75</sup> See Joel Davidow, 'Antitrust, Foreign Policy, and International Buying Cooperation', *The Yale Law Journal*, Vol. 84, No. 2, 1974, p. 269; Maher Debbah, *Supra.*, note 12, p. 211; Lawrence Sullivan and Warren Grimes, *Supra.*, note 11, p. 18.

<sup>76</sup> See David Round, 'Regional Cooperation in Competition Policy' in Erlinda Medalla (ed), *Competition Policy in East Asia*, Routledge, London and New York, 2005, p. 242.

trading countries can seriously impede competition, and also trade.<sup>77</sup> In fact, foreign suppliers can affect the market power of domestic firms. This is true if the foreign firms are large and can quickly and easily produce goods for penetrating markets across borders. The most obvious way foreign firms can limit the market power of domestic firms is when foreign competitors distribute their goods in the domestic market in direct competition with domestic firms.<sup>78</sup>

Competition law on vertical restraints, then, appears central to issues of market access, which are important to competition and trade. Vertical restraints imply geographic restrictions, and a competition authority's attacks on them would seem to encourage free-flowing international transaction.<sup>79</sup> On the contrary, a great emphasis in vertical restraint economics theory has been placed on efficiency-improvement. Vertical restraints may enhance efficiency. At the international level, nevertheless, these restraints may impede the entry of foreign products, which can be foreclosed from the market by lack of access of distribution channels. The main problem of conflict between trading countries will be then the different traditions of competition law. Therefore, the disparity in competition law enforcement places foreign enterprises in some markets at a competitive disadvantage,<sup>80</sup> although the interaction between foreign enterprises and national competition enforcement reduces divergence between the competition rules.<sup>81</sup>

Although the foreign entrant can expect equal treatment, there is still an issue of how effective domestic competition policy is. A weak competition policy may be a substitute for market protection, enabling domestic enterprises to block market entry of more efficient foreign suppliers. There will be, of course, distortion of competition incurred by a weak

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<sup>77</sup> Maher Debbah, *Supra.*, note 12, pp. 214-6.

<sup>78</sup> See Richard Caves, 'International Trade and Industrial Organization: Introduction', *The Journal of Industrial Economics*, Vol. 29, No. 2, 1980, pp. 113-7; William Shepherd, 'Theories of Industrial Organization' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, pp. 56-7; George Hay, John Hilke, and Philip Nelson, 'Foreign Competitors and Potential Competition: Geographic Market Definition in an International Context' in Harry First, Eleanor Fox, and Robert Pitofsky (eds), *Revitalizing Antitrust in Its Second Century: Essays on Legal, Economic, and Political Policy*, Quorum Books, New York, 1991, pp. 352-3.

<sup>79</sup> See Stephen Calkins, 'Reflections on Vertical Restraints of Trade and National Competition Laws in an Integrated World Economy' in Einar Hope and Per Maeleng (eds), *Competition and Trade Policy*, Routledge, London and New York, 1998, p. 211.

<sup>80</sup> Michael Utton, *Supra.*, note 3, pp. 46-7.

<sup>81</sup> See Kyu Uck Lee, *Competition and Trade in the Post-Uruguay Round Period: The Case of the Republic of Korea*, UNCTD, UNCTAD/ITD/11, 10 February 1995, p. 13: [http://www.unctad.org/en/docs/poitd\\_11.en.pdf](http://www.unctad.org/en/docs/poitd_11.en.pdf) (accessed 23 August 2008).

competition policy.<sup>82</sup> Korea used to have the barrier scheme of hybrid restraints of trade from coordination between the government and *Chaebols*. However, since the MRFTA legislation, the KFTC and the courts have tried to create a hard line of prohibition of market concentration. This strict measure has created a discriminatory system against *Chaebols*. Korean competition policy seeks to minimise the social cost of *Chaebols*, although measuring social cost has proved to be an elusive task, and difficult to minimise.<sup>83</sup> Therefore, the existing legal provision on vertical restraints does not incur the problem of entry barriers. Furthermore, the suggested reform also does not block market access of foreign firms, because it is not discriminatory. The KFTC should be aware that although Korean competition law is national, its market is already global.<sup>84</sup> As long as the Korean market is open to foreign enterprises, this will be more common.

### 7.3.2. Choice of Vertical Regulation Enforcement: Case of Japan

This section will discuss why the new vertical regulation may be effective in the Korean market by comparison with the Japanese case. Japanese experience is particularly relevant to Korea that has recently emerged from a developmental stage, and is in the process of developing competition-oriented economies.<sup>85</sup> In particular, it would be beneficial to discuss competition law on anti-competitive conduct by *Keiretsu* in Japan, to compare with the Korean policy on *Chaebols*.<sup>86</sup> The Japanese Antimonopoly Law (AML) underwent a number of reforms in the 1990s. These changes were conceived under the influence of the US model, making Japanese competition law appear similar.<sup>87</sup> Traditionally, however, the concept of fair and free competition was not the norm in the Japanese market, and unfamiliar to the public in general. Accordingly, Japanese firms were willing to cooperate with each other to compete

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<sup>82</sup> See Donald Hay, 'United Kingdom' in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington, D.C., 1997, pp. 199-200; Eleanor Fox and Robert Pitofsky, 'United States' in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington, D.C., 1997, p. 239. This problem of private blockage of market access and the extent to which competition law can and should be used to control the openness of markets has been often raised to the level of international discussion.

<sup>83</sup> See Herbert Hovenkamp, 'Chicago and Its Alternatives', *Duke Law Journal*, Vol. 1986, 1986, p. 1026.

<sup>84</sup> See Eleanor Fox, 'Antitrust and Regulatory Federalism: Races Up, Down, and Sideways', *New York University Law Review*, Vol. 75, 2000, p. 1781.

<sup>85</sup> Toshiaki Takigawa, *Supra.*, note 3, p. 162.

<sup>86</sup> For discussion about the types of anti-competitive conduct by *Keiretsu*, see Frederic Scherer, *Supra.*, note 8, p. 77; Chris Noonan, *Supra.*, note 3, pp. 185-6.

<sup>87</sup> Russell Weintraub, *Supra.*, note 3, p. 33; Kevin Kennedy, *Supra.*, note 3, p. 1; Kenji Suzuki, *Competition Law Reform in Britain and Japan: Comparative Analysis of Policy Networks*, Routledge, London and New York, 2002, p. 1.



with foreign firms. This was recognised as a national priority. After the US occupation ended in the 1940s, demands for wider relaxation in competition enforcement increased rapidly in Japan. Japanese competition policy was primarily discussed amongst businessmen, politicians, and public agencies in charge of industrial and competition policy.<sup>88</sup> Nonetheless, weak enforcement of competition law on vertical restraints in Japan has been criticised as a practice that results in an unfair advantage for Japanese firms in the domestic market.<sup>89</sup>

Under relaxed competition law enforcement, Japanese firms were also blamed for gaining profits from anti-competitive practices, such as cartels and restrictive distribution practices. As a result, restrictions on entry to the Japanese market imposed by government regulations or resulting from anti-competitive practices by private firms, have protected the market from the competition of foreign entrants.<sup>90</sup> Much controversy over vertical restraints as impediments to international trade has centred on claims that Japanese distribution channels are limited to foreign suppliers.<sup>91</sup> It seemed to appear that less rigid enforcement on vertical restraints could cause the problem discussed in the Japanese case. However, the main problem in law on vertical restraints involves potential trade-offs between market power which may inhibit international trade, and efficiency gains, such as reduction of transaction costs.<sup>92</sup> Understanding of this may, then, help Korean policy-makers have a better trade-off policy to solve this dilemma.

Similar to *Chaebols*, the vertical relationship by *Keiretsu* has had major consequences for competition in the industry. *Keiretsu's* control over a vast network of distribution led to tight vertical restrictions that directly facilitated horizontal and anti-competitive practices.<sup>93</sup> *Keiretsu* was, thus, represented as a near impenetrable barrier to the Japanese market.<sup>94</sup>

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<sup>88</sup> *Ibid.*, Kenji Suzuki, pp. 7-39.

<sup>89</sup> See Stephen Hamilton and Kyle Stiegert, 'Vertical Coordination, Antitrust Law, and International Trade', *Journal of Law and Economics*, Vol. 43, No. 1, 2000, pp. 152-3.

<sup>90</sup> See Kenji Sanekata and Stephen Wilks, 'The Fair Trade Commission and the Enforcement of Competition Policy in Japan' in Bruce Doern and Stephen Wilks (eds), *Comparative Competition Policy: National Institutions in A Global Market*, Clarendon Press, Oxford, 1996, p. 106; Philippe Aghion and Rachel Griffith, *Competition and Growth: Reconciling Theory and Evidence*, The MIT Press, Cambridge MA, USA and London, 2005, p. 1.

<sup>91</sup> Frederic Scherer, *Supra.*, note 8, p. 77; Barbara Spencer and Larry Qiu, 'Keiretsu and Relationship-Specific Investment: A Barrier to Trade?', *International Economic Review*, Vol. 42, No. 4, 2001, p. 893.

<sup>92</sup> See Paul Joskow, 'The Role of Transaction Cost Economies in Antitrust and Public Utility Regulatory Policies', *Journal of Law, Economics, & Organization*, Vol. 7, 1991, p. 81.

<sup>93</sup> See René Belderbos and Peter Holmes, 'An Economic Analysis of Matsushita Revisited', *The Antitrust Bulletin*, Vol. 40, Issue 4, 1995, pp. 828-9.

<sup>94</sup> Sylvia Ostry, *Supra.*, note 20, p. 35.

Japan's distinctive forms of *Keiretsu* have become a contentious issue in policy and academic debates concerning market competition in Japan and the openness of the Japanese market.<sup>95</sup> These issues raised by *Keiretsu* were underrated in the light of Japanese industrial organisation aims to facilitate productive efficiency.<sup>96</sup> However, there is a major difference between Korea and Japan in competition policy on large firms.

Korean competition policy has adopted the idea of a market economy, which facilitates stringent provision against large firms. It is true that Japanese competition policy focused on private monopolies, *Keiretsu*, from the beginning of legislation. However, its coalition with macroeconomic policy for economic development created relaxation of implementation. On the contrary, Korean competition law has been amended in order to prevent market dominance of *Chaebols*, and rigid enforcement has not been eroded. Furthermore, *Chaebols* have less tight and concentrated membership than Japanese *Keiretsu*, although some *Chaebols* are vertically integrated into 'one-set-production' systems.<sup>97</sup> The mere name *Chaebol*, the market concentration trend, has attracted the KFTC's attention, through terminology in Articles 3-2 and 23 MRFTA. However, again this seems unreasonable, and theoretically controversial in vertical cases. This should raise criticism to the rationale of having such stringent implementation on vertical restraints. The Korean competition authority preserves vigorous enforcement, especially in vertical cases, and has a history of a larger number of decisions than other regimes.<sup>98</sup> Sometimes this policy looks like

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<sup>95</sup> There was a trade imbalance issue between the US and Japan in the late 1980s, and this became so remarkable as to cause the American public to believe that there were serious structural impediments in the Japanese market. In particular, there were 6 topics concerning structural impediments in the Japanese market, and 3 of them (distribution, restrictive trade practices, and the *Keiretsu*) were closely related to competition policy. The trade conflicts between the US and Japan created stronger competition provisions in the 1990s, such as penalty and surcharge and also attempts to clarify the regulatory criteria for implementation of law. See Robert Lawrence and Gary Saxonhouse, 'Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups', *Brookings Papers on Economic Activity*, Vol. 1991, No. 1, 1991, pp. 314-5; Annette Bongardt, 'Vertical Interfirm Relations: A Competition Policy Issue?' in Leonard Waverman, William Comanor, and Akira Goto (eds), *Competition Policy in the Global Economy: Modelities For Competition*, Routledge, New York, 1997, 307-43; Paul Sheard, 'Keiretsu, Competition, and Market Access' in Edward Graham and David Richardson (eds), *Global Competition Policy*, Institute for International Economics, Washington, D.C., 1997, pp. 501-5; Kenji Suzuki, *Supra.*, note 87, pp. 93-8.

<sup>96</sup> See Ronald Gilson and Mark Roe, 'Understanding the Japanese Keiretsu: Overlaps between Corporate Governance and Industrial Organization', *The Yale Law Journal*, Vol. 102, No. 4, 1993, pp. 885-95. The authors argue that a hybrid of vertical integration and contracting of *Keiretsu* improves productive efficiency.

<sup>97</sup> See Ishida Hideto and John Haley, 'Anticompetitive Practices in the Distribution of Goods and Services in Japan: The Problem of Distribution Keiretsu', *Journal of Japanese Studies*, Vol. 9, No. 2, 1983, pp. 319-34; Robert Feenstra and Gary Hamilton, *Emergent Economies, Divergent Paths: Economic Organization and International Trade in South Korea and Taiwan*, Cambridge University Press, Cambridge, 2006, p. 41.

<sup>98</sup> See Keith Hylton and Fei Deng, 'Antitrust Around the World: An Empirical Analysis of the Scope of Competition Laws and Their Effects', *Antitrust Law Journal*, Vol. 74, 2007, p. 332. E.g., the empirical analysis

an attempt to eliminate large firms, which would create disruption of the market economy whilst disregarding its outcomes.<sup>99</sup>

To summarise, where imports are brought for distribution to the domestic market by large foreign firms directly engaged in foreign trade, the foreclosure against import competition is undermined. Market penetration could grow even in a concentrated industry.<sup>100</sup> Furthermore, vertical foreclosure by *Chaebols* does not appear to be a serious concern, even in distribution, when the KFTC implements unbiased law. Along with the competitiveness of the Korean manufacturing industry, a remarkable change has taken place in Korean distribution, since the government removed restrictions that effectively had prevented foreign suppliers from competing in the domestic market. Large retailers such as *Samsung-Tesco* and *Costco* have contributed to price competition that has benefited consumers. They have had a direct or indirect influence on modernisation and competitiveness of domestic firms by attracting consumers.<sup>101</sup>

Therefore, the adoption of the new vertical regulation does not necessarily mean weak enforcement of market foreclosure. The Japanese competition authority failed once in harmonising the aims of competition law and international trade by its weak enforcement. Some scholars criticise the AML for protecting the Japanese market.<sup>102</sup> However, the traditional enforcement of the KFTC has been strong. Furthermore, competition law legislation itself cannot be discriminatory against foreign rivals by means of protecting domestic firms, because of its intrinsic measures for pro-competitive achievement. Of course, market entry of foreign firms can be restrained by the presence of strong vertical integration by *Chaebols*. However, foreign firms will find alternative way of penetration. Moreover, high domestic concentration can tend to encourage aggressive penetration by foreign firms, unless imports are hampered by the public restraints.<sup>103</sup> These practices by large firms are common

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in 2004 shows that the Korean competition enforcement of total index score (effective competition law) is much higher than the Japanese.

<sup>99</sup> See Ohseung Kwon, *Kyoung-Jae-Bub [Economic Law]*, 5th edn, Bubmunsa, Seoul, 2005, p. 163. The author argues that one time elimination of large firms in the concentrated market may cause seriously negative externalities on the Korean economy.

<sup>100</sup> Michael Utton and A.D. Morgan, *Supra.*, note 27, p. 75.

<sup>101</sup> See Wan-Soon Kim and You-Il Lee, *The Korean Economy: The Challenges of FDI-led Globalization*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2007, p. 90.

<sup>102</sup> Eleanor Fox, *Supra.*, note 13, pp. 12-3.

<sup>103</sup> Michael Utton and A.D. Morgan, *Supra.*, note 27, p. 39.

worldwide, and vertical arrangements by *Chaebols* should be generalised.<sup>104</sup> The new vertical regulation will control any anti-competitive abusive conduct of market dominant firms, and improve efficiency and inter-brand competition through the block exemption provision. This principle will be applied to any enterprises in the Korean market.

#### 7.4. Final Thought from Modernisation

##### 7.4.1. Competition Policy Design from Economics: the Age of Efficiency

Economics can be employed in relation to Korean competition law. It should be applicable to each individual case to justify an enterprise's position. Therefore, attempts to avoid the problems of economics may result in an unsound competition policy.<sup>105</sup> Competition law, especially on vertical restraints, should be an interdisciplinary combination of law, economics, and interaction between competition regimes.<sup>106</sup> Korean competition law and policy have been influenced by other competition regimes, the US,<sup>107</sup> the EC, and, largely, Japan, but not entirely. For instance, although US law developed its antitrust policy as economics evolved, the Korean authority has not fully developed its economic rationale in vertical cases, because of its different historical and cultural background, mainly from *Anti-Chaebol* policy. This less-economics focused approach is, as argued in this thesis, very wrong. The present law is not a sufficient tool for efficiency enhancement. In short, too much tolerance of the vertical restraints or excessive prohibition on them should not be allowed. Accordingly, the KFTC must design newly structured legal provisions on vertical restraints, through an attempt to value the nature of vertical restraints.

To eliminate the problem of ambiguity in vertical arrangements, the KFTC should adopt the approach of a certain market share threshold test. Vertical foreclosure in the domestic market can be harmless, where the market share foreclosed is trivial. Therefore, the KFTC should consider that efficiency could be improved by increased foreign competition.

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<sup>104</sup> Toshiaki Takigawa, *Supra.*, note 3, p. 169.

<sup>105</sup> See Mark Furse, *Competition Law of the EC and UK*, 6th edn, Oxford University Press, Oxford, 2008, p. 7.

<sup>106</sup> Clifford Jones, *Supra.*, note 71, pp. 18-9.

<sup>107</sup> See Timothy Grendell, 'The Antitrust Legislation of the United States, the European Economic Community, Germany and Japan', *The International and Comparative Law Quarterly*, Vol. 29, No. 1, 1980, p. 64.

Accordingly, the KFTC has to make its competition policy work directly to keep the market open and maintain vigorous competition.<sup>108</sup> An efficiency-promotion approach in modernisation will not erect trade barriers and enhance monopoly power. The Korean market can be more competitive under the influence of imports, which force domestic enterprises to improve the quality of their products or services and reduce prices. Through this process, competition can be improved. As a consequence of globalisation, the market is more likely to be competitive.

Vertical restraints have complex potential pro- and anti-competitive effects. Since they can enhance or reduce market access by foreign-based competitors, vertical restraints need to be examined carefully upon a case-by-case basis. Therefore, if the anti-competitive impact of a restraint is clear, but pro-competitive justifications exist, abbreviated market analysis under the rule of reason and market share threshold test will be useful to reach the judgment of trade-off.<sup>109</sup> In the Korean market, where a number of competing enterprises are sufficient to maintain market competitiveness, vertical restraints cannot be presumed to be anti-competitive, although they should be subject to increased scrutiny if they potentially exclude foreign and domestic entrants.<sup>110</sup> In conclusion, the amendment to Articles 3-2, 19, 23, and 29 MRFTA will not hamper international trade, and the new vertical guidelines will give legal certainty not only to domestic but also foreign firms in the Korean market. This benefit, based on economic efficiency rationale, will increase overall business transactions of international trade flow.<sup>111</sup>

#### 7.4.2. Vertical Regulation Reform for Clarifying Objectives of Competition Policy

It is not easy to achieve a consistent goal of competition policy, because macro- and microeconomic policies change. In particular, developing countries of small markets are likely to have a wide range of goals for competition policy, responding to changing economic

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<sup>108</sup> Frederic Scherer, *Supra.*, note 3, p. 89.

<sup>109</sup> For further discussion about the US approach, see ABA, *Supra.*, note 45, p. 26.

<sup>110</sup> See UNCTD, *Exclusionary Anti-Competitive Practices, Their Effects on Competition and Development, and Analytical and Remedial Mechanisms*, UNCTAD/DITC/CLP/2005/4, Geneva, 2005, pp. 57-8: [http://www.unctad.org/en/docs/ditclp20054\\_en.pdf](http://www.unctad.org/en/docs/ditclp20054_en.pdf) (accessed 23 August 2008).

<sup>111</sup> See Ki-Su Lee and Jin-Hee Ryu, *Kyoung-Jae-Bub [Anti-trust and Consumer Law]*, 7th edn, Sechang Publishing, Seoul, 2006, pp. 202-3. The authors argue that the unique UBP provision, Article 23, will give benefits of prevention of anti-competitive practices by foreign firms, which Article 3-2 cannot cover. As the market is more open, the importance of Article 23 will increase.

policies. This is because the economic situations of many developing countries may require broad social objectives to be built into the goals of competition policy. However, the Korean competition authority has to dictate a consistent economics-focusing competition policy when the market is open to global competition.<sup>112</sup> It is important for policy-makers to consider non-economic goals, such as consumer welfare.<sup>113</sup> However, a general prescription that competition law should maximise consumer welfare gives very vague guidance for developing specific competition rules that will facilitate a proper balance between competitiveness and economic progress.<sup>114</sup> Furthermore, non-economic goals in competition policy do not help courts or competition authorities draw distinctions between harm and benefit by vertical restraints. They must be able to articulate standards that do so at a reasonable cost, and without deterring beneficial conduct.<sup>115</sup> However, efficiency goals can give clearer guidance to courts and competition authorities.

In Korea and Japan the consumer welfare objective seems over-emphasised, for instance, in the cases, *Intel*<sup>116</sup> and *Microsoft*.<sup>117</sup> In these cases, the competition regimes protected consumers and imposed remedies, which went beyond what was necessary, as

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<sup>112</sup> For further discussion regarding developing countries and their diverse competition goals, see Maher Debbah, *Supra.*, note 12, pp. 55-6; UNCTD, *Supra.*, note 69, p. 11.

<sup>113</sup> E.g., *Korean Medical Association v. KFTC*, Supreme Court 2001Du5347, Feb. 20, 2003; *Deawoo Co., Ltd. et al. v. KFTC*, Supreme Court 2001Du2935, Oct. 14, 2004. The Court stated that the purpose of non-economic goals such as public interests and consumer benefits are important factors of fair transactional order under the MRFTA.

<sup>114</sup> Herbert Hovenkamp, *Supra.*, note 68, p. 14.

<sup>115</sup> See Alan Meese, 'Exclusive Dealing, the Theory of the Firm, and Raising Rivals' Costs: Toward a New Synthesis', *The Antitrust Bulletin*, Vol. 50, No. 3, 2005, p. 347.

<sup>116</sup> *Intel Corp., Intel Semiconductor Ltd, and Intel Korea*, KFTC Decision 2008-295, 2007Dokgam1790 and 2008Sijang1126, Nov. 5, 2008. On 13 May 2009, the EC Commission also found that *Intel's* business practices in the EU infringed Art. 82 EC since its practices harmed consumers. In particular, *Intel's* practices undermined competition and innovation, and eventually this led to reduced choice for consumers. For further detail, see <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/745&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed 14 May 2009).

<sup>117</sup> *Microsoft Japan*, JFTC Decision, Dec. 14, 1998, *Shinketushu* 45-153; *Microsoft Co.*, KFTC Decision 2006-042, 2002Kyoungchok0452 and 2005Kyoungchok0375, Feb. 24, 2006. The JFTC also concluded that the significant harm would be to the consumer in the future from *Microsoft's* tying practice. However, some argue that KFTC's remedy went beyond what is necessary to protect consumers. Declan McCullagh, 'Feds side with Microsoft in Korea flap', ZDNet, Dec. 7, 2005: [http://news.zdnet.com/2100-3513\\_22-5985912.html](http://news.zdnet.com/2100-3513_22-5985912.html) (accessed 12 April 2009). The KFTC and the JFTC clearly rejected the notion of Chicagoans' argument of which tying is an irrational and unsustainable practice. Then, balance between consumer welfare and efficiency seems to be major issue in Korea and Japan. This problem can be also seen in the EC regime, e.g. Case T-201/04, *Microsoft Corp. v Commission*, [2007] ECR II-000, [2007] 5 CMLR 846. For further discussion, see Masako Wakui, *Supra.*, note 3, p. 147; Daniel Silverthorn, 'Microsoft Tying Consumers' Hands? The Windows Vista Problem and the South Korean Solution', *Michigan Telecommunication and Technology Law Review*, Vol. 13, 2007, pp. 617-27; Ian Eagles and Louise Longdin, 'Microsoft's Refusal to Disclose Software Interoperability Information and the Court of First Instance', *European Intellectual Property Review*, Vol. 30, No. 5, 2008, p. 205; David Howarth and Kathryn McMahon, "'Windows has performed an Illegal Operation": the Court of First Instance's Judgment in Microsoft v Commission', *European Competition Law Review*, Vol. 29, No. 2, 2008, pp. 127-30.

discussed in Chapter 4. In fact, where non-economic goals conflict with the goal of economic efficiency, the KFTC may not promote both goals.<sup>118</sup> Where the cases involve situations in which a business practice such as vertical restraints has both anti-competitive and efficient effects, a balancing technique must be utilised to draw appropriate decisions.<sup>119</sup> It should strive to achieve economic efficiency as a priority, since efficiency will improve the economy and consumer welfare in the long run. Currently, Korean scholars started considering efficiency as a major purpose of the MRFTA, which should not be undermined by other social objectives.<sup>120</sup>

Pursuit of redistribution of wealth through protection of consumers and SMEs at the expense of efficiency will be costly for the Korean economy, because inefficient enterprises will be preserved in the market. Such protection of SMEs may even harm consumers, by preventing inefficient producers from realising cost savings or product innovation. This cost of SME protection will be wholly or partially transferred to consumers. If such protection were consistently pursued, it would influence the whole scope of the market and state economy, since protection of SMEs would make little contribution to social goals. Therefore, the KFTC should protect competition rather than competitors, through more efficiency-enhancing and inter-brand competition pursuit. The harm to competitors does not necessarily mean harms to competition. In *POSCO*,<sup>121</sup> the Supreme Court has articulated that the protection of competitors rather than competition will increase the risk of hampering business activities and efficiency in the market economy system.

Economic and non-economic objectives of competition law may substantially diverge, when this protection of competition rather than competitors or inter-brand competition by the sacrifice of intra-brand dictates displacement of SMEs by larger firms. However, this is not easily implemented, because of the complicated priorities in Korea.<sup>122</sup> Moreover, some

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<sup>118</sup> The economic goal of a pro-competition policy is to improve the economy and promote consumer welfare through increased efficiency in the use and allocation of resources, and through the development of new and improved products, new techniques that further put economic resources to more beneficial use. See Donald Turner, 'The Virtues and Problems of Antitrust Law' in Theodore Kovaleff (ed), *The Antitrust Impulse: An Economic, Historical, and Legal Analysis Vol. II*, M.E. Sharpe, New York, 1994, p. 955.

<sup>119</sup> Malcolm Coate and Andrew Kleit, *Supra.*, note 60, p. 2.

<sup>120</sup> See Moon Ji Rhee, 'ABA Section of Antitrust Law Report on Antitrust Policy Objectives' *Journal of Business Administration and Law*, Vol. 15, No. 1, 2004, p. 132.

<sup>121</sup> *POSCO v. KFTC*, Supreme Court 2002Du8626, Nov. 22, 2007.

<sup>122</sup> Michal Gal, (Market Conditions under the Magnifying Glass) *Supra.*, note 72, pp. 314-7. The author further argues that the importance of efficiency as a stand-alone objective becomes highlighted in developing countries.

commentators argue that the distribution channel in Korea is sometimes very complicated and dominated by affiliates of *Chaebols*, which improves inter-brand competition but impedes intra-brand.<sup>123</sup> However, this argument may not be plausible, because inter-brand competition will produce better outcomes. If the market has a significant level of inter-brand competition, the KFTC should not be concerned excessively about restraints on intra-brand, although this may harm consumer welfare in the short run. Therefore, the easier way of facilitating economics-focused implementation of competition law will be to adopt the new vertical regulation.

Korean competition policy-makers seem to believe that the process of competition itself must not be only free, but also by understood a social norm, such as fair. They often assume that if the competition process is unfair, the freedom to compete loses its intrinsic value, since fair competition must go along with free competition. These two concepts embody one and the same value in Korea, as explicitly stated in Article 1 MRFTA. This may be the reason why MRFTA clearly specifies ‘fair and free competition’ as its major objective. The KFTC’s policy focuses on the issue of *Chaebols*, implying that market power was not fairly distributed and, therefore, competition policy had to play an important role in helping SMEs become strong in the process of competition, and of establishing the legal techniques of fair and free competition.<sup>124</sup> Some believe that the definition of competition has cultural and normative content,<sup>125</sup> and that Korea should accept this rather than economic principles. Accordingly, the MRFTA defines unfairness more broadly than other regimes. This term embraces methods of competition that it perceives to be fair, as shown in the Articles 3-2 and 23 cases.<sup>126</sup> In particular, the over-emphasis of the term unfairness in vertical restraints has curbed application of the rule of reason. Competition policies around the world, however,

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In small economies of developing countries, social goals should be given little or no independent weight in formulating competition policy.

<sup>123</sup> Ohseung Kwon, *Supra.*, note 99, p 327.

<sup>124</sup> This is the same rhetoric shown in the US antitrust history discussed by Peritz. See Rudolph Peritz, ‘A Counter-History of Antitrust Laws’, *Duke Law Journal*, Vol. 1990, No. 2, 1990, p. 264.

<sup>125</sup> See Eleanor Fox, ‘What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect’, *Antitrust Law Journal*, Vol. 70, 2002, pp. 407-8; Eleanor Fox, ‘We Protect Competition, You Protect Competitors’, *World Competition*, Vol. 26, No. 2, 2003, pp. 163-4. The author referenced the speech of Kyu Uck Lee.

<sup>126</sup> *Ibid.*, Eleanor Fox, (We Protect Competition), p. 163. An unfair competition component of competition policy may be anathema to policy-makers in mature market jurisdictions because this can protect competitors from competition itself. From the point of view of the developed competition regimes, application of this has no benefits except to the protected competitors.



seek a mixture of efficiency and fairness in their markets,<sup>127</sup> and it seems difficult to eliminate this language in the MRFTA.

Competition laws are, nevertheless, designed to protect the process of competition. For most of the history of competition regimes around the world, the objectives of competition laws were stated primarily in terms of notions which the society desired. In particular, factors of macroeconomic policy can influence competition law.<sup>128</sup> At various times, diverse concerns about fairness, such as for SMEs, stability of market economy, equality of business opportunity, and economic liberty have been included in the MRFTA.<sup>129</sup> If Korean competition law demonstrates the costs of moving towards fairness for equality in exchange for efficiency, it will eventually create the destruction of the state economy.<sup>130</sup> This problem seems to have appeared particularly in the KFTC's enforcement of Unfair Business Practice (UBP) provision under Article 23 MRFTA, which was originated from the adoption of the Japanese UBP provision.

As a result of UBP's vague definition of unfairness, the JFTC finds illegality in vast areas of business conduct. Excessively broad illegality standards of the UBP provision has hindered rather than helped the JFTC to actively enforce the AML against vertical restraints.<sup>131</sup> The KFTC has the same burden on its UBP enforcement, which was initially brought in from the language of unfairness. Competition authorities should endeavour to establish as clear and economically meaningful standards as possible. For this objective, ambiguous phrases such as unfairness or unreasonableness should be avoided in the vertical regulation.<sup>132</sup> This language needs to be replaced by anti-competitiveness. A regulatory reform of vertical regulation will be the most important step for clarifying from the linguistic to practical implementation in order to achieve the objectives of Korean competition law.

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<sup>127</sup> This is because efficiency may not always maximise wealth. For further discussion see Robin Malloy, *Law and Market Economy: Reinterpreting the Values of Law and Economics*, Cambridge University Press, Cambridge, 2000, pp. 137-48.

<sup>128</sup> For example, the political and diplomatic changes impacted on the AML. These facilitated the relaxation of economic reform. See Masako Wakui, *Supra.*, note 3, p. 11.

<sup>129</sup> See Hwang Lee, 'Tying Arrangement As A Kind of Unfair Trade Practices: Discussions About A Recent Case', *Journal of Korean Competition Law*, Vol. 14, 2006, p. 258.

<sup>130</sup> See Robert Bork, *The Antitrust Paradox: A Policy at War with Itself*, The Free Press, New York, 1993, p. 423; David Gerber, *Supra.*, note 29, pp. 272-3. Bork argues that egalitarianism in the sense of a desire for outcome of equality rather than of opportunity is a prominent feature in many fields of law in the society. This is often emphasised in Korea.

<sup>131</sup> Toshiaki Takigawa, *Supra.*, note 3, pp. 172-3.

<sup>132</sup> *Ibid.*, p. 174.

## 7.5. Concluding Remarks

A large number of changes in Korean competition policy should be created for a more efficient and market-friendly environment. Along with improvement of product market structures and competition, Korean competition law and policy on vertical restraints should be developed by adopting economic theories. This includes reforms associated with the macroeconomic policy of the Free Trade Agreement (FTA) with other regimes for opening up the domestic market in numerous ways. Furthermore, it is possible to harmonise between competition and economic growth in vertical issues. To achieve this aim, it is the one of the most important tasks for the KFTC to assess and examine how great the social cost of vertical restraints is. If vertical restraints by large enterprises are very harmful to the market, the KFTC should not allow the positive impact from the practices. The new vertical regulation is designed to enhance economic welfare by preventing creation and misuse of market power of large firms whilst ensuring efficiency improvement. The new vertical guidelines and amendments to Articles 3-2, 4, 19, 23, and 29 MRFTA will improve overall vertical structure in the Korean market.

The primary objectives of this amendment are, first, to ensure a pro-competitive outcome by the vertical restraints in the domestic market and, second, to improve international trade. On the first objective, there is no common ground of understanding of vertical restraints between different competition regimes around the world, including abuse of dominant position. Substantial differences between their competition policies on vertical restraints will possibly remain.<sup>133</sup> However, there is an increasing opinion that vertical restraints are unlikely to violate competition laws. Basic assumptions about the causation of competitive harm have been fundamentally revised in the light of economic theories. In vertical cases, only where an enterprise with significant market power restricts the competitive freedom of others without pro-competitive justification, is it likely to be considered violation of competition law.<sup>134</sup> On the second objective, competition enforcement of strict prohibitions on vertical restraints in order to address market access problems can increase the particular problems of counter-attack on domestic firms, especially when facing

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<sup>133</sup> See Warren Grimes, 'Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited', *California Law Review*, Vol. 80, 1992, p. 853.

<sup>134</sup> David Gerber, *Supra.*, note 29, p. 283.

efficient modes of distribution. The important question is whether vigorous competition brought from foreign rivals will be increased, even though domestic concentration is high. If there is no public restraint against foreign firms, however, more penetration by foreign firms is predicted, because they are more competitive than domestic firms in the global market. Then, entry barriers will be gradually eroded in the long run. Therefore, if domestic competition is becoming vigorous, the KFTC and the courts need to allow a more economic-efficiency approach in vertical restraint cases. The new vertical restraints will be the first move towards this achievement.

## Chapter 8

## Conclusion

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This thesis has attempted to identify what the main problems are in Korean competition law and policy on vertical restraints, when facing the open market. It has focused on vertical restraint as one of the controversial areas of competition law, and examined it in the context of Korea. To this end, the thesis adopts an economics and comparative approach by looking at the US, the EC and Japanese competition regimes through analysis of Korean competition law on vertical restraints. This has brought discussion of crucial problems in the Monopoly Regulation and Fair Trade Act (MRFTA) on vertical restraints (vertical regulation) and, thus, critically analysed the current implementation and case law. It then suggested amendments to provisions on abuse of market dominance, unfair concerted practice, Unfair Business Practice (UBP), and Resale Price Maintenance (RPM). The major question in this thesis was whether the Korea Fair Trade Commission (KFTC) and the courts need to consider a better competition law standard, based on micro- and macroeconomic levels. Regarding this, the thesis further discussed globalised vertical regulation through economic principles and comparative studies, which would improve domestic competition, and international trade also. Since Korean society is very aware of the influence of global economic changes, Korean competition law and policy on vertical restraints requires to be amended and developed, so that globalisation does not impede trade. It should be, moreover, responsive to changes in the global environment. Therefore, it is important to find how the KFTC and the courts examine the domestic market, and the influence from international rivals on Korean market competition.

In order to solve the problem, we first looked at the historical development of the Korean economy and competition policy, and how this influenced the market competition in Korea. In effect, the extreme fear from market concentration by *Chaebols* created a rigid rule

on vertical restraints, and resulted in inefficiency outcomes. This myopic concern of the competition authority created significant side effects. The role and behaviour of *Chaebols* dictated the way in which the KFTC could apply relevant competition law. However, the globalisation of economic activity, rapid technological developments, and the progressive elimination of trade restraints, are vitally important factors which the KFTC pays little attention to. The KFTC keeps strict measures on vertical restraints, although it appears that the race of efficiency-priority legislation by competition regimes around the world is increasingly popular. Furthermore, the Korean market has become more open and interconnected with the global market, as competition is increasingly transcending national boundaries and penetrating deeply into markets. Some scholars are concerned that the process of free trade has shifted the emphasis from public restraints to private restraints as obstacles to international trade flow. This often leads to increased concern over the relation between trade and competition policies, and their consequences for international trade, especially in vertical restraints. For example, anti-competitive effects of vertical restraints appear to the extent that domestic enterprises act successfully in preventing foreign competitors from entering the domestic market, by foreclosing access to distribution channels locally.<sup>1</sup> It is, therefore, obvious that freer trade means increased market competition from penetration by foreign firms, and more competition in the domestic market. Thus, policies that ensure free international trade, as far as possible, are an important element in a foundation of pro-competitive policies.<sup>2</sup>

Domestic market competition from foreign firms can prevent the exercise of market power by large domestic firms. As long as the Korean market remains reasonably open to global competition, the large domestic firms cannot generate distortion of domestic market competition. However, the KFTC mistakenly underestimates the significance of foreign competition, and focused on the problem of market access, disregarding efficiency and pro-competitive effects of vertical restraints. The KFTC needs to develop the current provisions more clearly for domestic and foreign economic entities to create positive outcomes. Some may argue that the new vertical regulation suggested in this thesis can give incentives to pursue strategies that protect and nourish large national companies, since it may look more

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<sup>1</sup> See Einer Hope and Per Maeleng, *Competition and Trade Policy*, Routledge, London and New York, 1998, pp. 1-5.

<sup>2</sup> See Victor Norman, 'A Small Open Economy Perspective on International Competition Policy' in Einer Hope and Per Maeleng (eds), *Competition and Trade Policy*, Routledge, London and New York, 1998, p. 61.

relaxed than the current policy for domestic firms. However, the reform is not discriminatory, which means the suggested amendments cannot be a means of trade protection. Accordingly, the view on economic efficiency by vertical restraints is more obvious than may appear, and what the KFTC should pay attention to. If there is no harm expected from vertical restraints, the next task of the KFTC is to provide more a market-friendly policy based on efficiency-economics. Economic efficiency by vertical restraints should not be jeopardised, although the intent and consequences of vertical restraints are sometimes complex. Even competition lawyers and economists' evaluations of them diverge, and do not produce unanimous opinion. It is, therefore, unsurprising that national competition laws on vertical restraints differ widely, both internally and across borders.<sup>3</sup> In addition, legal and economic analysis of vertical restraints sometimes faces a problem from a systematic description of guidance that competition law should focus on non-economic goals;<sup>4</sup> this is the current problem in the MRFTA. Furthermore, Korean competition law has not received sufficient benefits from economic theories, especially in its vertical regulation. On the contrary, competition authorities and courts in the US and the EC have rarely suffered from a lack of economic theories on vertical restraints. Hence, the KFTC should develop its competition law through more sound economic theories, and applying legal techniques from other regimes which have exercised legal provisions on vertical restraints based on economic principle.

Firms whose goods are traded in competitive markets generally have no market power, and cannot raise competition policy concerns. If their practice engages in imperfectly competitive markets, on the other hand, they may enjoy market power. In this case, competition authorities attempt to regulate these firms through the use of competition law.<sup>5</sup> In fact, the size of a firm determines violation of competition law, disregarding its business activity in the Korean competition regime, and efficiency-economics has been disregarded from the fear of largeness of *Chaebols*. Under the MRFTA, the KFTC prevents a number of internal trading activities of Korean holding companies, such as cross-shareholdings and cross-debt guarantees, disregarding the positive effects of reduction of transaction costs. This

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<sup>3</sup> See Frederic Scherer, *Competition Policies for an Integrated World Economy*, The Brookings Institute, Washington D.C., 1994, p. 70.

<sup>4</sup> See Peter Carstenesen, 'The Competitive Dynamics of Distribution Restraints: Efficiency versus Rent Seeking' in Antonio Cucinotta et al (eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2002, p. 281.

<sup>5</sup> See Andrew Guzman, 'International Competition Law' in Andrew Guzman and Alan Sykes (eds), *Research Handbook in International Economic Law*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2007, p. 432.

is already discriminatory against domestic large firms. It is clear that the MRFTA was established on the aim of restrictions on large business groups, regardless of their efficiency. The choice in Korean jurisdiction has been made to obtain the goal of protecting consumer and Small and Medium-sized Enterprises (SME) at the expense of efficiency and economic growth. This *Anti-Chaebol* competition policy has been accepted, since the Korean market was believed to be and evaluated as imperfectly competitive. Furthermore, social problems, such as concentration of wealth by *Chaebols*, have created this stringent policy. Korean competition law was adopted in an environment where economic activity is already highly concentrated, mainly due to past government policies and interventions. It has evolved as not only a means to prevent anti-competitive practices, but also to pro-actively strengthen small economic entities in the market. Therefore, the MRFTA is explicitly concerned about competition being impeded by the market dominance of large enterprises, but does not mention economic efficiency.<sup>6</sup> The KFTC often seems to believe that competition and efficiency diverge. Nonetheless, competition itself fosters efficiency.

In particular, the position of productive and dynamic efficiency, of taking new methods to distribution, e.g., e-commerce,<sup>7</sup> in achieving continuous economic growth and welfare in society has been acknowledged by economists, lawyers, and policy-makers around the world. A desire to foster competition encourages productive and innovative activities, and this should be acknowledged in competition law enforcement, especially on vertical arrangements in the new economy.<sup>8</sup> Furthermore, many jurisdictions that have adopted a competition law find efficiency desirable.<sup>9</sup> It is certainly true that in the absence of market power, which implies the absence of entry barriers, vertical restraints may have positive effects. In practice, many markets are likely to exhibit varying degrees of market power

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<sup>6</sup> However, a language of efficiency is also hardly observed in statutes in other competition regimes, e.g., the US antitrust acts. See Keith Leffler, 'Toward a Reasonable Rule of Reason: Comments', *Journal of Law and Economics*, Vol. 28, No. 2, 1985, p. 383.

<sup>7</sup> See Warren Grimes, 'Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited', *California Law Review*, Vol. 80, No. 4, 1992, pp. 848-50; Wolfgang Kerber and Simonetta Vezzoso, 'EC Competition Policy, Vertical Restraints, and Innovation: An Analysis from an Evolutionary Perspective', *World Competition*, Vol. 28, No. 4, p. 515.

<sup>8</sup> See Richard Nelson and Sidney Winter, 'Simulation of Schumpeterian Competition', *The American Economic Review*, Vol. 67, No. 1, 1977, pp. 273-4; Marcus Glader, *Innovation Markets and Competition Analysis: EU Competition Law and US Antitrust Law*, Edward Elgar, Cheltenham, UK, 2006, pp. 4-5.

<sup>9</sup> See Daniel Gifford and Thomas Sullivan, 'Can International Antitrust Be Saved for the Post-Boeing Merger World? A Proposal to Minimize International Conflict and to Rescue Antitrust From Misuse', *The Antitrust Bulletin*, Vol. 45, Issue 1, 2000, pp. 88-9.

maintained by barriers to entry,<sup>10</sup> as in Korea. Therefore, the KFTC should balance the positive and negative effects from vertical restraints. Competition law and policy on vertical restraints cannot be used for protecting SMEs or large competitors, but protecting competition, thereby enhancing efficiency and innovation in distribution that may result in economic growth. Protecting SMEs only or even excessively can cause harm to competition. It may be difficult for the KFTC to find a fully-fledged theory regarding vertical restraints. This may happen where the incumbent large enterprise engages in vertical arrangements. Therefore, some questions of regulatory reform should be addressed. First, should competition law enforcement pursue violations without market power? Second, how can the KFTC assess the problem of the efficiency of vertical restraints? Third, are there conditions under which the KFTC should allow market power to stimulate efficiency?<sup>11</sup> These questions may still remain after the amendments. However, the suggested amendments to the MRFTA will give guidance to solve these problems, although they may not be perfect in some circumstances. Articles 19 and 23 MRFTA will prevent anti-competitive practices without market power held by a firm, which Article 3-2 does not cover. Market share threshold guidance will also offer better assessment techniques of efficiency. Finally, the balance test of efficiency, and pro-competitive effects under the new vertical guidelines and the rule of reason, will provide criteria of requirements for efficiency justification for large firms.

Based on the 30 per cent market share threshold test, the KFTC can clarify the application of law. The Korean market is confident that this new method will give some benefits, which have been recognised in the EC. First, more categories of agreements are automatically exempted. Although there may be some externalities from the categorisation process of the courts,<sup>12</sup> this categorisation will give more, of reducing litigation costs, than losses. Second, firms become freer to make vertical agreements according to their needs, although the agreements concluded by firms with significant market power cannot receive benefits from block exemption.<sup>13</sup> If the market share thresholds are met under the new vertical guidelines, the burden should shift to the firm to prove two things: (i) clear purposes

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<sup>10</sup> See Michael Utton, *International Competition Policy: Maintaining Open Markets in the Global Economy*, Edward Elgar, Cheltenham, UK and Northampton MA, USA, 2006, p. 48.

<sup>11</sup> See Joseph Brodley, 'Post-Chicago Economics and Workable Legal Policy', *Antitrust Law Journal*, Vol. 63, 1995, pp. 683-4.

<sup>12</sup> For further discussion about the US categorisation issue and its problems, see Mark Lemley and Christopher Leslie, 'Categorical Analysis in Antitrust Jurisdiction', *Iowa Law Review*, Vol. 93, 2008, pp. 1260-63.

<sup>13</sup> These benefits are observed in the EC. See Romano Subiotto, 'The Reform of the European Competition Policy Concerning Vertical Restraints' *Antitrust Law Journal*, Vol. 69, 2001, p. 193.



of business that can be justified; and (ii) no less restrictive alternatives to the vertical restraint. If the firm's practice meets the criteria, it should normally be approved.<sup>14</sup>

According to the Guidelines for the review cartel (Cartel Guidelines),<sup>15</sup> the KFTC can trade-off between efficiency and anti-competitiveness in soft cartel cases. However, it is difficult to observe an actual case based on the Cartel Guidelines.<sup>16</sup> This is because the KFTC and the courts have not established a clear trade-off test yet. It is important to trade-off between negatives and positives by vertical restraints. The process of weighing competitive benefits against harm to competition is the essence of the rule of reason development. Article 3-2 MRFTA cases should be also evaluated under this standard.<sup>17</sup> A current outstanding judgment of the Supreme Court has illustrated the Court's attempts to refine competition law to fit the aims of the law, which are especially designed for the Korean market. The Court in *POSCO*<sup>18</sup> signalled its endeavours to eliminate obscure implementation of law by articulating the definition of Article 3-2 violation in refusal to deal where (i) Article 3-2 infringement can be deemed as perpetrated with intent or the objective of maintaining or reinforcing monopolistic status; and (ii) it is likely to have anti-competitive effects from the objective point of view. Despite this effort, some issues still remain unexplained. The *POSCO* case could have given better solutions for the problem in vertical restraints under the full rule of reason. The Court, however, failed to examine the compatibility of the various economic principles.

It is somewhat difficult to measure the impacts of vertical restraints through economic principles for establishing a legal standard. However, the courts can still measure the impacts on the market based on the degree of market power. In particular, the current development in the KFTC's decision shows its increasing use of economics. The courts and the competition authority in Korea have become more comfortable with evidence from economic analysis, as

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<sup>14</sup> Even some of the US approaches are useful for the KFTC to examine the balance test. See Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, 3rd edn, Thomson West, St. Paul, MINN, USA, 2005, pp. 493-59.

<sup>15</sup> Sec. III.2. of the KFTC Guidelines for review cartel, amended on Dec. 21, 2007. See *Supra.*, Chapter 7.

<sup>16</sup> See Meong Cho Yang, 'Comments on 2005 Korean Supreme Court Cartel Decisions', *Journal of Korean Competition Law*, Vol. 14, 2006, p. 162.

<sup>17</sup> This approach can be observed in the US. Although the rule of reason evolved out of the case law under sec. 1 of the Sherman Act, monopolisation claim under sec. 2 has been evaluated under this rule as well. See ABA, *Antitrust Law and Economics of Product Distribution*, ABA Publishing, Chicago, 2006 p. 28.

<sup>18</sup> *POSCO v. KFTC*, Supreme Court 2002Du8626, Nov. 22, 2007.

the volume of studies in economics of vertical restraints have increased.<sup>19</sup> This development will influence development of the rule of reason in the courts, as observed in the US. Some commentators are sceptical about the rule of reason development through efficiency-economics.<sup>20</sup> However, the rule of reason is an important judicial means that is relevant to many cases, including vertical restraints, where considerations of efficiency require subtle judgments and balancing of arguments. This inevitably leads to the trade-off principle, balancing the efficiency gains against the anti-competitive effects.<sup>21</sup> For completion of this balance test, the US approach of rule of reason enquiry is an attractive experiment for the Korean competition regime. However, a single specific theory cannot explain all cases of vertical practices,<sup>22</sup> and a case-by-case approach may not bring legal certainty.<sup>23</sup> Therefore, the rule of reason development, along with market share threshold guidance, will adjust this problem, and lead to more certainty through economic theories. The best method to achieve this is to implement a proper economic rationale of rule of reason from clearer criteria, along with the new vertical regulation. This will help the KFTC establish a better structure of vertical regulation, in order to satisfy the objectives of Korean competition law.

In modern society, the economic life of citizens is inspired by the liberal ideal. Here, the absence of government intervention of competition law enforcement in market activities is seen as a necessary condition for wealth. However, the inherent tendency of large enterprises to restrict competition to increase profits from their market dominant position induces anti-competitive practices. They may make use of the idea of business freedom in order to restrain their competitors' freedom to contract. Therefore, competition policy inevitably establishes a set of restrictions on the freedom of business activities.<sup>24</sup> This theory has dominated Korean competition jurisdiction, as observed in the current vertical cases. This

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<sup>19</sup> The development of economics in the competition litigation has also affected the development of the rule of reason in the US. See Phillip Areeda, 'A Second Century of the Rule of Reason', *Antitrust Law Journal*, Vol. 59, 1990, pp. 145-6.

<sup>20</sup> See Eleanor Fox and Lawrence Sullivan, 'Antitrust-Retrospective and Prospective: Where Are We Coming From? Where Are We Going?' *New York University Law Review*, Vol. 62, 1987, p. 968. The authors argue that the courts will eliminate a bundle of theoretic literature from the Chicago School.

<sup>21</sup> See Roger Van den Bergh and Peter Camesasca, *European Competition Law and Economics: A Comparative Perspective*, Intersentia, Antwerpen, Belgium, 2001, p. 252.

<sup>22</sup> See Ralph Winter, 'Vertical Control and Price versus Nonprice Competition', *The Quarterly Journal of Economics*, Vol. 108, No. 1, 1993, p. 70.

<sup>23</sup> See Richard Posner, 'The Next Step in the Antitrust Treatment of Restrictive Distribution: Per Se Legality' *The University of Chicago Law Review*, Vol. 48, No. 1, 1981, p. 22.

<sup>24</sup> See Donald Dewey, *The Antitrust Experiment in America*, Columbia University Press, New York, 1990, p. 18; Doris Hildebrand, *The Role of Economic Analysis in the EC Competition Rules*, 2nd edn, Kluwer Law International, The Hague, 2002, p. 9.

is the outcome of orthodox thought of fairness in competition. However, unfair and rigid enforcement without an economics principle created anti-competitive outcomes. Korean competition policy on vertical restraints must adapt to the rapid evolution of economics, as well as globalisation. This change will make the KFTC revise the MRFTA on vertical restraints, to a less strict level than in the first legislation. Some may argue that the current stringent rule on vertical restraints is necessary to make a better market structure, which has been influenced by *Chaebols*. Nevertheless, maintaining the current provision, especially in order to change the market structure, is a risky proposition. The only way of creating competitive market structure is free competition through the open market. Korean competition policy will be developed by economics debates and analysis of the statutes, with reference to other competition regimes, as it should be. Korean Competition law has travelled a rough road since the first legislation, and its development will continue perpetually. Korean competition law evolves through reforms, as the market economy and business practices change. The following step from this should be the adoption of the principles of the competition law of efficiency. This will improve the pro-competitive environment in the domestic market without impeding trade.

## **APPENDIX. SUBSTANTIVE LEGISLATIONS (EXCERPTS)**

### ***THE REPUBLIC OF KOREA***

#### **Constitution of the Republic of Korea, amended Oct. 29, 1987**

##### Article 23

- (1) The right to property of all citizens is guaranteed. Its contents and limitations are determined by law.
- (2) The exercise of property rights shall conform to the public welfare. (3) Expropriation, use, or restriction of private property from public necessity and compensation therefore are governed by law. However, in such a case, just compensation must be paid.

##### Article 119

- (1) The economic order of the Republic of Korea is based on a respect for the freedom and creative initiative of enterprises and individuals in economic affairs.

##### Article 127

- (1) The State strives to improve the national economy by developing science and technology, information and human resources, and encouraging innovation.
- (2) The State establishes a system of national standards.
- (3) The President may establish advisory organisations necessary to achieve the purpose referred to in Paragraph (1).

#### **Monopoly Regulation and Fair Trade Act, amended by the law no. 9554, Mar. 25, 2009**

##### Article 1 (Purpose)

This Act seeks to promote fair and free competition such that creative enterprising activities are fostered, to protect consumers, and to strive for the balanced development of the national economy by preventing the abuse of market dominance by enterprisers and excessive concentration of economic power and by regulating improper cartels and unfair business practices.

##### Article 2 (Definitions)

For the purpose of this Act, the terms used herein shall have the following definitions: <Amended on December 8, 1992, December 30, 1996, February 5, 1999, January 16, 2001, December 31, 2004, April 27, 2007, August 3, 2007>

1. The term “enterpriser” refers to a person who operates a manufacturing business, a service business, or any other business. Any officer, employee, agent, or other person acting in the interest of the enterpriser shall be considered an enterpriser in relation to the application of provisions pertaining to the enterprisers’ organization.

1-2. The term “holding company” pertains to a company that makes its primary business the control of any domestic company's business through the ownership of stocks (including equities; the same shall apply hereinafter) and whose total assets are above the amount set by the Presidential Decree. In this case, the standards for primary business shall be prescribed by the Presidential Decree.

1-3. The term “subsidiary” refers to a domestic company whose business is controlled by the holding company under the criteria prescribed by the Presidential Decree.

1-4. The term “business-related sub-subsidiary” pertains to a domestic company whose business is controlled by subsidiaries. A business-related sub-subsidiary is closely related to the subsidiaries concerned as per the Presidential Decree.

2. The term “Business Group” pertains to a group of companies whose businesses are substantially controlled by the same person according to the following pursuant to the standards prescribed by the Presidential Decree:
  - A. The “same person” is a company or a group composed of such person and one or more companies he/she controls.
  - B. The “same person” is not a company or a group composed of two or more companies he/she controls.
3. The term “affiliated company” refers to the case wherein two or more companies belong to the same Business Group; each company is an “affiliated company” of the others.
4. The term “enterprisers’ organization” pertains to a juristic person or federation organized by two or more enterprisers for the purpose of promoting their common interests regardless of the organization's form.
5. The term “officer” refers to a director, a representative director, a managing partner with unlimited liability, an auditor, or a person in a similar position or a commercial employer who is capable of carrying out general business for the main office or a branch office, e.g., manager, etc.
6. The term “resale price maintenance” pertains to an act of trading goods or services wherein an enterpriser compels a counterpart enterpriser or another enterpriser by the next stage of transaction to sell or provide them only at a price fixed in advance at each stage of distribution or executes transactions under any agreement or binding condition for such purpose.
7. The term “market-dominating enterpriser” refers to any enterpriser enjoying Market Dominance and possibly determining, maintaining, or changing the prices, quantity, or quality of commodities or services or other terms and conditions of business as a supplier or a customer in a particular business area individually or jointly with other enterprisers.
8. The term “particular business area” pertains to an area wherein any competitive relation exists by subject, stage, or geographical area of such trade, or there is a possibility of such.
- 8-2. The term “practices practically suppressing competition” refers to any of the practices that affect or threaten to affect the setting of price, quantity, quality, or other terms or conditions of trading in accordance with the intent of a certain enterpriser or an enterprisers’ organization owing to reduced competition in a particular business area.
9. The term “credit” pertains to any loan and guarantee or acceptance of company obligations by domestic financial institutions.
10. The term “financial industry or insurance industry” refers to any of the financial and insurance businesses under the Korea Standard Industrial Classification as notified by the Commissioner of the Korea National Statistical Office pursuant to the provision of Clause 1, Article 22 (Standard Classification) of the Statistical Act.

#### Article 2-2 (Application to Extra-Territorial Activities)

The Act shall apply even to activities carried out overseas when they are deemed to have influence on the domestic market.

[Newly established on December 31, 2004]

#### Article 3-2 (Prohibition on the Abuse of Market Dominance)

(1) No market-dominating enterpriser shall commit any of the following acts (hereinafter referred to as “abusive acts”): <Amended on February 5, 1999>

1. Act of determining, maintaining, or changing the price of commodities or services unreasonably (hereinafter referred to as “price”)
2. Act of unreasonably controlling the sale of commodities or provision of services
3. Act of unreasonably interfering with the business activities of other enterprisers
4. Act of unreasonably impeding the participation of new competitors
5. Act of unfairly excluding competitive enterprisers or act that may considerably harm the interest of consumers

(2) The categories or standards for abusive acts shall be specified by the Presidential Decree. <Newly established on December 30, 1996, February 5, 1999>

[Moved from Article 3 <December 30, 1996>]

#### Article 4 (Presumption of Market-Dominating Enterpriser)

An enterpriser with any of the following market shares in a particular business area (excluding an enterpriser whose annual sales and/or purchases in a regular field of trade amount to less than KRW4 billion) shall be presumed to be a market-dominating enterpriser as referred to in Clause 7, Article 2 (Definitions): <Amended on August 3, 2007>

1. The market share of one enterpriser is 50/100 or more.
2. The total market share of at least three enterprisers is 75/100 or more, excluding those whose market share is less than 10/100 [Amended on February 5, 1999]

#### Article 5 (Corrective Measures)

In case of any act violating the provisions of Article 3-2 (Prohibition on the Abuse of Market Dominance), the Fair Trade Commission may order the market-dominating enterpriser involved to reduce prices, discontinue the violation, announce its receipt of a corrective order to the public, and take other measures required for correction. <Amended on December 30, 1996, December 31, 2004>

#### Article 6 (Surcharge)

In case of abusive acts by a market-dominating enterpriser, the Fair Trade Commission may slap such enterpriser with surcharges equal to not more than 3 percent of the turnover specified by the Presidential Decree (referring to the profits of the business particularly for the person designated by the Presidential Decree; the same shall apply hereinafter). In the absence of a turnover, or in case of difficulty in computing the turnover under the Presidential Decree (hereinafter referred to as “in the absence of turnover, etc.”), however, surcharges of not more than KRW1 billion may be imposed.

[Amended on December 30, 1996]

#### Article 19 (Prohibition on Improper Cartels)

(1) No enterpriser shall agree with other enterprisers by contract, agreement, resolution, or any other means to engage jointly in any of the following acts or let others engage in such kinds of activities that unfairly restrict competition (hereinafter referred to as “improper cartels”): <Amended on December 8, 1992, December 22, 1994, December 30, 1996, February 5, 1999, December 31, 2004, August 3, 2007>

1. Act of fixing, maintaining, or changing prices
2. Act of determining the terms and conditions for the transactions of goods or services or payment of prices thereof
3. Act of restricting production, delivery, transportation, or transaction of goods or services
4. Act of limiting the territory of trade or customers
5. Act of preventing or restricting the establishment or extension of facilities or installation of equipment required for the production of goods or rendering of services
6. Act of restricting the types or specifications of goods or services in producing or transacting goods or services
7. Act of jointly carrying out and managing the main parts of a business or establishing a company, etc., to carry out and manage the main parts of a business jointly
8. Act of deciding matters prescribed by the Presidential Decree, e.g., bidding price, auctioning price, auctioneer, or bidder in bids or auctions
9. Any practice that substantially minimizes competition in a particular business area by means other than those under Items 1~8 or interferes with or restricts the activities or contents of the business

(2) The provision of Clause (1) shall not apply if unfair collaborative acts are deemed by the Fair Trade Commission to meet the requirements specified in the Presidential Decree in case they are committed for any of the following purposes: <Newly established on December 30, 1996>

1. Industry rationalization
2. Research and technology development
3. Overcoming economic depression
4. Industrial restructuring
5. Rationalization of trade terms and conditions

#### 6. Enhancement of competitiveness of small and medium enterprises

(3) Any and all relevant policies with respect to the standards, methods, and procedures for authorization under Clause (2) and modification of authorized matters shall be specified by the Presidential Decree. <Newly established on December 30, 1996, February 5, 1999>

(4) Any contract, etc., stipulating the improper cartels listed in Clause (1) between enterprisers shall be null and void.

(5) If two or more enterprisers commit any of the acts listed in Clause (1) and practically restrict competition in a particular business area, they shall be presumed to have committed an unfair collaborative act despite the absence of an explicit agreement to engage in such act. <Amended on August 3, 2007>

(6) The Fair Trade Commission may establish and announce the criteria for examining improper cartels. <Newly established on August 3, 2007>

#### Article 21 (Corrective Measures)

Where an enterpriser commits any act in violation of the provisions of Clause 1, Article 19, the Fair Trade Commission may order the enterpriser to discontinue the act, announce the receipt of corrective order, or take other corrective measures. <Amended on December 30, 1996, December 31, 2004>

#### Article 22 (Surcharge)

The Fair Trade Commission may impose on those demonstrating any behavior violating the provision of Clause 1, Article 19 a surcharge of not more than 10 percent of the turnover as prescribed by the Presidential Decree. In the absence of turnover, etc., however, a surcharge of not more than KRW2 billion may be imposed. <Amended on December 31, 2004>

[Amended on December 30, 1996]

#### Article 23 (Prohibition on Unfair Business Practices)

(1) No enterpriser shall commit any of the following acts that are likely to impede fair trade (hereinafter referred to as “unfair business practices”) or make an affiliated company or other enterprisers perform such acts: <Amended on December 30, 1996, February 5, 1999, April 13, 2007>

1. Act that unfairly rejects any transaction or discriminates against a certain transacting partner

2. Act designed to exclude competitors unfairly

3. Act of unfairly coercing or inducing customers of competitors to deal with the enterpriser in question

4. Act of engaging in a trade with a transacting partner by unfairly taking advantage of its position in the business area

5. Act of trading under terms and conditions that unfairly restrict or disrupt business activities

6. Deleted <February 5, 1999>

7. Act of assisting a person with special interest or other companies by providing advanced payment, loans, manpower, immovable assets, stocks and bonds, or intellectual properties or by transacting under substantially favorable terms

8. Any act that threatens to impair fair trade other than those listed in Items 1~7

(2) The categories or standards for unfair business practices shall be prescribed by the Presidential Decree. <Amended on December 30, 1996>

(3) If necessary for the prevention of acts violating the provisions of Clause (1), the Fair Trade Commission may establish and announce the guidelines to be observed by enterprisers.

(4) To prevent the unreasonable inducement of customers, enterprisers or enterprisers’ organization may voluntarily write a code (hereinafter referred to as “fair competition code”). <Amended on February 5, 1999>

(5) The enterprisers or an enterprisers’ organization may request that the Fair Trade Commission examine whether or not the fair competition code as referred to in Clause (4) violates the provisions of Clause (1) 3 or 6.

#### Article 24 (Corrective Measures)

When an act in violation of the provisions of Article 23 (1) is committed, the Fair Trade Commission may order the enterpriser concerned to discontinue such unfair business practices, to delete any pertinent provision from a

contract, to announce the receipt of corrective order to the public, or to take other necessary corrective measures against such act. <Amended on December 30, 1996, February 5, 1999, December 31, 2004>

#### Article 24-2 (Surcharge)

In case of practices in violation of the provisions of Clause 1, Article 23, the Fair Trade Commission may impose on the person concerned a surcharge of not more than two percent (five percent in case the provisions of Item 7 are violated) of the turnover prescribed by the Presidential Decree. In the absence of turnover, however, a surcharge of not more than KRW500 million may be imposed. <Amended on December 28, 1999, December 31, 2004>

[Amended on December 30, 1996]

#### Article 29 (Restrictions on Resale Price Maintenance)

(1) No enterpriser shall engage in resale price maintenance. Note, however, that this provision shall not apply to cases wherein there are justifiable reasons in terms of the maximum price maintenance preventing the transactions of commodities or services in excess of the specified prices. <Amended on January 16, 2001>

(2) The provisions of Clause (1) shall not apply to literary works prescribed by the Presidential Decree or to those commodities meeting the following conditions and receiving designation in advance from the Fair Trade Commission as being eligible for resale price maintenance:

1. The uniformity in quality of the commodity concerned is easily identifiable.
2. The commodity concerned is used daily by ordinary customers.
3. Free competition exists with respect to the commodity concerned.

(3) Any enterpriser wishing to be designated as per Clause (2) shall apply with the Fair Trade Commission under the conditions prescribed by the Presidential Decree.

(4) Whenever it designates a commodity as eligible for resale price maintenance under Clause (2), the Fair Trade Commission shall make such fact public.

#### Article 30 (Modification of Resale Price Maintenance)

If an enterpriser producing or selling a commodity designated and made public by the Fair Trade Commission under Article 29 (4) concludes a contract to determine and maintain the resale price of such commodity, but the contract threatens to cause serious harm to the interest of consumers or contradicts public interest, the Fair Trade Commission may order the modification of such contract. <Amended on August 3, 2007>

[Amended on February 5, 1999]

#### Article 31 (Corrective Measures)

When an act violates the provisions of Article 29 (1), the Fair Trade Commission may order the enterpriser concerned to discontinue such act, announce the receipt of corrective order to the public, or take other necessary corrective measures against such act. <Amended on December 30, 1996, December 31, 2004>

#### Article 31-2 (Surcharge)

For resale price maintenance in violation of Article 29, the Fair Trade Commission may impose on the enterpriser concerned a surcharge of not more than two percent of the turnover as prescribed by the Presidential Decree. In the absence of turnover, however, a surcharge of not more than KRW500 million may be imposed.

[Amended on December 30, 1996]

#### Article 66 (Penal Provisions)

(1) The following persons shall be slapped with a jail term of not more than three years or a fine of not more than KRW200 million: <Amended on December 8, 1992, December 30, 1996, February 24, 1998, February 5, 1999, December 28, 1999, January 16, 2001, January 26, 2002, December 31, 2004, April 13, 2007, August 3, 2007>

1. Person who has committed an abusive act in violation of the provisions of Article 3-2
2. Person who has combined enterprises in violation of Article 7 (1)
3. Person who has violated the provisions of Article 8-2 (2) or (5)



4. Person who has established a holding company or converted a company into a holding company in violation of Article 8-3
  5. Person who has acquired or owned stocks in violation of the provisions of Article 9 or 10 (1), excluding the person subject to an order of prohibition as per Article 17-2 (1) (including the applicable case as per Article 4 of the Addenda) from among those violating Article 10 (1)
  6. Person who has guaranteed a debt in violation of the provisions of Article 10-2 (1)
  7. Person who has exercised his/her voting rights in violation of the provisions of Article 11 or 18
  8. Person who has evaded the law in violation of the provisions of Article 15
  9. Person who has engaged in unfair collaborative practices or encouraged others to participate in such in violation of the provision of Article 19 (1)
  10. Person who has engaged in prohibited practices involving an enterprisers' organization in violation of Article 26 (1) 1
- (2) Both a jail term and a fine as referred to in Clause (1) may be imposed concurrently.

#### Article 67 (Penal Provisions)

The following persons shall be slapped with a jail term of not more than two years or a fine of not more than KRW150 million:<Amended on December 8, 1992, December 22, 1994, December 30, 1996, February 24, 1998, February 5, 1999, January 26, 2002, August 3, 2007>

1. Deleted <December 30, 1996>
2. Person who has engaged in unfair trade practice in violation of Article 23 (1)
3. Person who has violated the provisions of Article 26 (1) 2~5
4. Person who has engaged in resale price maintenance in violation of Article 29 (1)
5. Person who has concluded an international contract in violation of Article 32 (1)
6. Person who has failed to comply with the corrective measures or order of prohibition, etc., as per Articles 5, 16 (1), 17-2 (1), 21, 24, 27, 30, 31, or 34
7. Person who has failed to undergo audit by a certified public accountant in violation of the provisions of Article 14 (5)

### **Enforcement Decree of Monopoly Regulation and Fair Trade Act, amended by presidential decree no. 21148, Dec. 3, 2008**

#### Article 5 (Types of and Criteria for Abusive Acts)

①“Unreasonable fixing, maintenance, or alteration of price” as per Item 1, Clause (1), Article 3-2 (Prohibition on the Abuse of Market Dominance) of the Act pertains to a sharp increase or insignificant decrease in the price/cost of goods or services relative to the changes in the supply and demand or in the supply cost without justifiable reason (limited to general or similar businesses).

②“Unreasonable control of the sale of goods or provision of services” as per Item 2, Clause (1), Article 3-2 (Prohibition on the Abuse of Market Dominance) of the Act refers to the following:

1. Significantly decreasing the supply of goods or services without justifiable reason and considering the recent trends

2. Decreasing the supply of goods or services despite a supply shortage in distribution without justifiable reason

③ “Unreasonably hampering another enterpriser's business activities” as per Item 3, Clause 1, Article 3-2 (Prohibition on the Abuse of Market Dominance) of the Act involves hindering another enterpriser's business activities by directly or indirectly engaging in any of the following acts: <Amended on March 27, 2001>

1. Hindering the purchase of raw materials required for the production of the other enterpriser without justifiable reason

2. Employing human capital indispensable to the business activities of another firm by granting or promising excessive economic compensation compared to normal practices

3. Refusing, discontinuing, or limiting the use of or access to essential facilities for the manufacture, provision, or sale of products or services of other enterprisers without justifiable reason

4. Engaging in unreasonable acts other than those in Items 1, 2, and 3 and deemed by the Fair Trade Commission to hinder the business activities of other enterprisers

④“Unreasonably hindering the entry of a new competitor” as per Item 4, Clause (1), Article 3-2 (Prohibition on the Abuse of Market Dominance) of the Act involves obstructing the entry of new competitors by directly or indirectly engaging in any of the following acts: <Amended on March 27, 2001>

1. Entering into an exclusive contract with a transaction partner without justifiable reason

2. Purchasing the rights, etc., required for the continued business activities of an established enterpriser without justifiable reason

3. Refusing or limiting the use of or access to essential facilities for the manufacture, provision, or sale of products or services of new competitors without justifiable reason

4. Engaging in unreasonable acts other than those in Items 1, 2, and 3 and deemed by the Fair Trade Commission to hinder the entry of new competitors

⑤“Unreasonable transaction to exclude competitors” as per Item 5, Clause (1), Article 3-2 (Prohibition on the Abuse of Market Dominance) of the Act pertains to any of the following:

1. Where there is a possibility of excluding a competitor by supplying goods or services at unreasonably low prices or purchasing goods or services at unreasonably high prices compared to the normal transaction price

2. Unreasonably transacting with a partner under the condition that the partner does not transact with a competing enterpriser

⑥The Fair Trade Commission may determine and announce the specific types of and criteria for Abusive Acts as referred to in Clauses (1)~(5).

[Amended on March 31, 1999]

#### Article 6 (Request for Price Investigation)

When there is substantial ground to suspect that a market-dominant enterpriser has unreasonably fixed, maintained, or altered the price of goods or services, the Fair Trade Commission may request for an investigation of the price of goods or services from the head of the relevant administrative agencies or from public institutions responsible for investigating consumer prices.

#### Article 8 (Method for the Public Announcement of Receipt of Corrective Order <Amended on March 27, 2001, March 30, 2002>)

The Fair Trade Commission may order the enterpriser concerned pursuant to Article 5 (Corrective Measures), Article 16 (Corrective Measures), Clause 1, Article 21 (Corrective Measures), Article 24 (Corrective Measures), Article 27 (Corrective Measures), or Article 31 (Corrective Measures) of the Act [in the case of Article 27 (Corrective Measures) of the Act, a business group (including member enterprisers when necessary)] to publicize its receipt of corrective order by setting the standards for the content, type and number of media, and size of space for such publication considering the following:

1. Content and degree of violations

2. Duration and frequency of violations <Amended on March 31, 1997, March 31, 1999, June 30, 1999, March 27, 2001, March 30, 2002>

#### Article 9 (Computation of Surcharges)

①“Turnover set forth in the Presidential Decree” as per Article 6 (Surcharges), Article 22 (Surcharges), Article 24-2 (Surcharges), Article 28 (Surcharges), Clause (2), Article 31-2 (Surcharges), and Article 34-2 (Surcharges) of the Act refers to an enterpriser's average turnover for the past three years (hereinafter referred to as “average turnover”). If the firm is less than three years old at the start of the relevant business year, however, the turnover shall be the annual average turnover adjusted from the total amount of turnover from the first day until the last day of business for the year immediately prior to the relevant business year; in case the firm commenced business during the relevant business year, the turnover shall be the annual average turnover calculated from the total turnover from the first day of operation until the date of violation. <Amended on April 1, 2004>

②Other details required for the computation of the average turnover shall be determined by the Fair Trade

Commission. <Amended on April 1, 2004>

[Amended on March 31, 1997]

Article 9-2 (Scope of Enterprisers Using Operating Revenue)

“An enterpriser as provided for by the Presidential Decree” as per Article 6 (Surcharges) of the Act pertains to an enterpriser entering in its financial statements the total price of goods or services as operating revenue.

[Amended on March 31, 1997]

Article 10 (Absence of Turnover, etc.)

“In the absence of turnover, or in case of difficulty in calculating the turnover as provided for by the Presidential Decree” as per Article 6 (Surcharges) of the Act refers to any of the following cases: <Amended on April 1, 2004>

1. There is no operating result because either business was not commenced or was suspended.

2. Deleted <April 1, 2004>

3. The computation of an objective turnover is difficult due to a disaster, etc., thereby causing data damage or loss in the course of calculating the turnover.

[Amended on March 31, 1997]

Article 24 (Criteria for the Authorization of Cartels)

“Criteria set forth in the Presidential Decree” in Clause (2), Article 19 (Restrictions on Improper Cartels) of the Act refer to the conditions stipulated in Article 24-2 (Criteria for Cartels for Purposes of Industry Rationalization) to Article 28 (Criteria for Cartels for Purposes of Enhancing the Competitiveness of Small and Medium Enterprises) of the Decree.

[Newly established on March 31, 1997]

Article 24-2 (Criteria for Cartels for Purposes of Industry Rationalization)

Authorization for cartels for the purpose of industrial rationalization as per Item 1, Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act shall be limited to cartels meeting the following conditions: <Amended on March 31, 1997, March 30, 2002>

1. Effects arising from the cartel such as technological enhancement, quality improvement, cost reduction, and efficiency increases are clearly manifested.

2. The rationalization of the industry using means other than the cartel is difficult.

3. The beneficial effects of industrial rationalization outweigh the effects of prohibiting the restriction of competition.

Article 24-3 (Criteria for Cartels for Purposes of Research and Technological Development)

Authorization for cartels for the purpose of research and technological development as per Item 2, Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act is limited to cartels meeting the following conditions:

<Amended on March 31, 1997, March 30, 2002>

1. The research and technological development are indispensable to the reinforcement of industrial competitiveness, and their economic impact is substantial.

2. The scale of investment required for research and technological development is too large for a single enterpriser.

3. Collaboration is necessary for the distribution of risks associated with the uncertainties of research and technological development results.

4. The beneficial effects of research and technological development outweigh the effects of prohibiting the restriction of competition.

[Newly established on February 20, 1993]

Article 25 (Criteria for Cartels for Purposes of Overcoming Economic Depression)

Authorization for cartels for the purpose of overcoming economic depression as per Item 3, Clause (2), Article

19 (Prohibition on Improper Cartels) of the Act is limited to cartels meeting the following conditions: <Amended on March 31, 1997>

1. There has been a continued decline in the demand for a particular product or service for a substantial period of time due to a continued large oversupply, and the situation will most likely persist in the future.
2. The transaction price of a particular product or service has persistently fallen short of the average production cost.
3. A considerable number of companies in a given area of trade will likely be unable to continue their business.
4. The circumstances in Items 1~3 cannot be overcome through the rationalization of enterprisers.

#### Article 26 (Criteria for Cartels for Purposes of Industrial Restructuring)

Authorization for cartels for the purpose of industrial restructuring as per Item 4, Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act is limited to cartels meeting the following conditions: <Amended on March 31, 1997, March 30, 2002>

1. There is a marked excess in capacity on the supply side in a particular industry due to a change in the economic environment at home or abroad, or production efficiency or international competitiveness has substantially decreased due to the deterioration of production facilities and methods.
2. The situation described in Clause (1) cannot be overcome through the rationalization of enterprisers.
3. The benefits of industrial restructuring outweigh the effects of restriction on competition.

#### Article 27 (Criteria for Cartels for Purposes of Rationalizing the Terms of Trade)

Authorization for cartels for the purpose of rationalizing the terms of trade as per Item 5, Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act is limited to cartels meeting the following conditions: <Amended on March 30, 2002>

1. The cartel significantly contributes to an increase in production efficiency, facilitation of transaction, and enhancement of convenience of consumers by rationalizing the terms of trade.
  2. The nature of rationalization of the terms of trade is technologically and economically viable for most enterprisers in the given area of trade.
  3. The benefits of rationalization of the terms of trade outweigh the effects of restriction on competition.
- [Newly established on March 31, 1997]

#### Article 28 (Criteria for Cartels for Purposes of Enhancing the Competitiveness of Small and Medium Enterprises)

Authorization for cartels for the purpose of enhancing the competitiveness of small and medium enterprises as per Item 6, Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act is limited to cartels meeting the following conditions: <Amended on March 31, 1997>

1. The cartel has a significantly positive effect on the productivity of small and medium enterprises, e.g., quality and technological improvement, or on the reinforcement of their bargaining power with respect to the terms of trade.
2. All participating enterprisers are small and medium enterprises.
3. There is no means of competing effectively with or countering large-scale companies other than the cartel.

#### Article 29 (Limitations on the Authorization of Cartels)

Notwithstanding Article 24-2 (Criteria for Cartels for Purposes of Industry Rationalization) up to Article 28 (Criteria for Cartels for Purposes of Enhancing the Competitiveness of Small and Medium Enterprises) of the Decree, the Fair Trade Commission shall not grant authorization for the following cartels: <Amended on March 31, 1997>

1. The cartel exceeds the necessary extent for the achievement of its purpose.
2. The interests of consumers and other related enterprisers will likely be compromised unreasonably.
3. The nature of the cartel unreasonably discriminates against participating enterprisers.
4. The participation in or withdrawal from the Cartel is unreasonably restricted.

#### Article 30 (Procedures for the Authorization of Cartels)

①Any person wishing to obtain authorization from the Fair Trade Commission as per Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act shall submit to the Fair Trade Commission an application specifying the following:<Amended on March 31, 1997>

1. Number of participating enterprisers
2. Names of the participating enterprisers and their office locations
3. Addresses and names of representative directors and officers
4. Reasons for and nature of the cartel
5. Proposed duration of the cartel
6. Business content of the participating enterprisers

②The following documents shall be attached to the application described in Clause (1): <Amended on March 31, 1997>

1. Business reports, balance sheets, and statements of income of the participating enterprisers for the past two years

2. Copy of the agreement or statement of resolution of the cartel
3. Documents verifying the satisfaction of criteria for authorization

4. Documents verifying the satisfaction of provisions of Article 29 (Limitations on the Authorization of Cartels) of the Decree

③When granting authorization upon receiving an application for such as per Clause (1), the Fair Trade Commission shall deliver a certificate of authorization to the applicant.

④A person who has been granted authorization but wishes to modify the details he/she submitted shall submit to the Fair Trade Commission an application for change containing the documents specified in Clauses (1) and (2) as necessary for the modified particulars together with a certification of authorization.

⑤Upon receiving an authorization application as per Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act, the Fair Trade Commission shall reach a decision within thirty days of receipt of such application [when making a public notification as outlined in Clause (3), Article 31 (Public Notification on the Contents of Application for the Authorization of Cartels) of the Decree, thirty days in addition to the public notification period]; when deemed necessary, however, the Fair Trade Commission may extend the period for up to thirty days. <Newly established on March 31, 1997>

#### Article 31 (Public Notification on the Contents of Application for the Authorization of Cartels)

①When deemed necessary, the Fair Trade Commission may announce the contents of an application for the authorization of cartels as submitted in accordance with Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act and hear the opinions of the interested parties. The same shall apply to cases of authorization modification. <Newly established on March 31, 1997>

②In announcing the contents of applications for the authorization of cartels or applications for the modification of some details, the following information shall be included in the announcement:<Amended on March 31, 1997>

1. Name and address of the applicant enterpriser
2. Nature of the cartel
3. Reasons for the cartel
4. Proposed period of the cartel
5. In the case of application for modification, the reason and nature of change

③The duration of announcement as per Clause (1) shall not exceed thirty days. <Newly established on March 31, 1997>

④An interested party with an opinion regarding the contents of the announcement described in Clause (2) may submit to the Fair Trade Commission a statement of opinion containing the following information within the period of announcement:

1. Name and address of the person stating an opinion
2. Opinion and reasons for its submission

### 3. Other materials required for stating an opinion

#### Article 32 (Discontinuance of Authorized Cartels)

Any person who has received authorization for a cartel as per Clause (2), Article 19 (Prohibition on Improper Cartels) of the Act but discontinues the authorized cartel shall immediately notify the Fair Trade Commission accordingly.

[Amended on March 31, 1999]

#### Article 36 (Designation of Unfair Business Practices)

①The types of and criteria for Unfair Business Practices as per Clause (2), Article 23 (Prohibition on Unfair Business Practices) of the Act are listed in Appendix 1.

②When deemed necessary, the Fair Trade Commission may establish and announce the detailed standards for the types of and criteria for Unfair Business Practices as per Clause (1) for purposes of applying them to a particular area or act. In this case, the Fair Trade Commission shall hear the opinions of the heads of the relevant administrative agencies in advance.

[Amended on March 31, 1997]

#### Article 37 (Fair Competition Code)

①Upon receiving a request for the examination of the Fair Competition Code as per Clause (5), Article 23 (Prohibition on Unfair Business Practices) of the Act, the Fair Trade Commission shall notify the requester of the examination results within sixty days of receiving the request. <Amended on March 31, 1997>

#### Article 43 (Publications Eligible for Resale Price Maintenance)

“Publications specified in the Presidential Decree” as per Clause (2), Article 29 (Restrictions on Resale Price Maintenance) of the Act refer to those publications defined in Article 2 (Definitions) of the Copyright Act and designated by the Fair Trade Commission following consultations with the head of the relevant central administrative agency (including electronic publications). <Amended on March 31, 1997, March 31, 1999, March 31, 2005>

#### Article 44 (Procedures for Designating Products Eligible for Resale Price Maintenance)

①An enterpriser wishing to receive designation of eligibility for resale price maintenance as per Clause (3), Article 29 (Restrictions on Resale Price Maintenance) of the Act shall submit to the Fair Trade Commission an application specifying the following: <Amended on March 31, 1997>

1. Nature of business
2. Operating results for the previous year
3. Nature of the product in question
4. Distribution channel of the product in question and trends in the sales price of each distribution level for the previous year
5. Organization of product sellers
6. Reasons for the application for the designation of eligibility

②The following documents shall be attached to the application described in Clause (1): <Amended on March 31, 1997>

1. Documents verifying that the resale price maintenance for the product in question does not unreasonably harm general consumer interests
2. Documents verifying the satisfaction of all conditions outlined in the Items of Clause (2), Article 29 (Restrictions on Resale Price Maintenance) of the Act

#### [Appendix 1] <Amended on March 30, 2002>

Types of and Criteria for Unfair Business Practices [related to Clause (1), Article 36]

1. Refusal to deal

“Unreasonably refusing to transact” as stipulated in Item 1, Clause (1), Article 23 (Prohibition on Unfair Business Practices) of the Act pertains to the following:

A. Collective refusal to deal

Refusing to initiate business with a certain enterpriser or suspending transaction or significantly restricting the quantity or nature of commodities or service in a transaction with a certain enterpriser with which you have forged a continuous transaction relation without justifiable reason and in collusion with your competitors

B. Other types of refusal to deal

Unreasonably refusing to initiate business with a certain enterpriser or suspending transaction or significantly restricting the quantity or nature of commodities or services in a transaction with a certain enterpriser with which you have forged a continuous transaction relation

2. Discriminatory treatment

“Unreasonable discrimination against certain transacting partners” as stipulated in Item 1, Clause 1, Article 23 (Prohibition on Unfair Business Practices) of the Act refers to the following:

A. Price discrimination

Depending on the transacting partner or transaction territory, unreasonably transacting at a highly favorable or unfavorable price

B. Discrimination in the terms and conditions of transaction

Unreasonable discrimination in the terms and conditions, e.g., quantity or quality in favor of or against a certain enterpriser

C. Discrimination in favor of affiliated corporations

Discrimination in trading terms and conditions such as price, quantity, or quality in favor of or against certain partners without justifiable reasons for the benefit of your affiliated corporations

D. Collective discrimination

A group unreasonably discriminates in favor of or against a certain enterpriser, thereby putting such enterpriser at a considerable advantage or disadvantage

3. Elimination of competitors

“Unreasonably excluding competitors” as stipulated in Item 1, Clause 2, Article 23 (Prohibition on Unfair Business Practices) refers to the following:

A. Unjustifiable discounts

Continuing to supply your commodities or services at a price that is considerably lower than the supply cost without justifiable reason or to supply such commodities or services at an unduly lower price, thereby threatening the viable existence of your competitors or those of your affiliated corporations

B. Unjustifiably high-priced purchase

Purchasing commodities or services at an unjustifiably higher cost than the normal transaction price, thereby threatening the viable existence of your competitors or those of your affiliated corporations

4. Unfairly luring customers

“Unreasonably luring customers of your competitors to deal with you ” as stipulated in Item 1, Clause 3, Article 23 (Prohibition on Unfair Business Practices) of the Act pertains to the following:

A. Luring customers by promising unjustifiable gains

Providing or promising to provide unjust or excessive gains in violation of normal business practices, thereby luring your competitor's customers

B. Luring customers using fraudulent means

Other than through labeling or advertising as provided for in Item 9, misleading your competitors' customers by falsely claiming that the content, terms and conditions, or other transaction matters involving your commodities or services are considerably superior to or much more advantageous than they actually are compared to those of your competitors, or that the content, terms and conditions, or other transaction matters involving your competitor's commodities or services are considerably less advantageous than or inferior to what they actually are compared to your commodities or services, thereby luring your competitors' customers

C. Luring customers through other methods

Unduly hindering transactions between your competitor and its customers by impeding the execution of contracts or by encouraging such customers to breach their contracts, thereby luring them

5. Coercion in dealing

"Unreasonably coercing the customers of your competitors to deal with you" as stipulated in Item (1), Item 3, Article 23 (Prohibition on Unfair Business Practices) of the Act refers to the following:

A. Tie-in sales

Wrongfully forcing the transaction partner to purchase another commodity or service from you or an enterpriser you designated when supplying commodities or services in violation of normal business practices

B. Forcing employees to purchase or make a sale

Wrongfully forcing your officers or employees or those of your affiliated corporation to purchase or sell your commodities or services or those of your affiliated corporation

C. Other types of coercion

Offering the transaction partner undue terms and conditions and other disadvantages in violation of normal business practices, thereby forcing the transaction partner to transact with you or the enterpriser you designated

6. Abuse of superior position

"Unreasonably taking advantage of your superior position when transacting with others" as stipulated in Item (1), Clause 4, Article 23 (Prohibition on Unfair Business Practices) of the Act pertains to the following:

A. Coercion to purchase

Forcing the transacting partner to purchase commodities or services that the transaction partner does not wish to purchase

B. Coercion to provide benefits

Forcing the transacting partner to provide economic benefits such as money, commodities, or services

C. Imposing a sales target

Imposing a target on the transacting partner for transactions involving the commodities or services you supply and forcing the transaction partner to meet the target

D. Offering disadvantages

Establishing or modifying the transaction conditions to the disadvantage of the transacting partner or placing the partner at a disadvantage in the course of carrying out the transaction using methods other than those described in Items 1~3

E. Interference in management



Interfering in the management activities of transaction partners by requiring them to obtain approval or directions from you when they hire or fire officers or employees or by restricting the manufacturing articles, scale of facilities, production quantity, or details of transaction

7. Transaction based on restrictive conditions

“Transacting with others under terms and conditions that unreasonably restrict business activities” as stipulated in Item (1), Clause 5, Article 23 (Prohibition on Unfair Business Practices) of the Act refers to the following:

A. Exclusive dealings

Wrongfully transacting with an enterpriser on the condition that the enterpriser does not deal with your competitor or those of your affiliated corporation

B. Restriction on the transaction area or partner

Transacting with a transaction partner on the undue condition that the partner limits its transaction area or partner(s)

8. Interference in the business activities of other enterprisers

“Acts that unreasonably disrupt the business activities of other enterprisers” as stipulated in Item (1), Clause 5, Article 23 (Prohibition on Unfair Business Practices) of the Act refer to any of the following acts:

A. Unfair use of technology

Unduly using the technology of the other enterpriser such that its business activities are seriously hampered

B. Unfairly luring or hiring personnel

Unreasonably luring or hiring the personnel of the other enterpriser such that its business activities are seriously hampered

C. Interference in the change of transacting partner

Unreasonably interfering in the change of transaction counterpart of the other enterpriser such that its business activities are seriously hampered

D. Interference through other methods

Interfering with the business activities of other enterprisers through unreasonable means other than those specified in Items 1~3 such that their business activities are seriously hampered

9. Deleted <June 30, 1999>

10. Undue financial, asset, and manpower support

The following acts constitute the act of unreasonably "providing specially related persons or other corporations with temporary payment, loan, manpower, real estate, securities, intangible property rights, etc., or aiding a special related person or other corporations by trading under extremely favorable terms" as per Item (1), Clause 7, Article 23 (Prohibition on Unfair Business Practices) of the Act:

A. Undue financial support

Aiding a specially related person or other corporations through the provision of excessive economic benefits by providing or transacting funds, e.g., temporary payment, loan, etc., at substantially high or low costs or by providing or transacting such funds in substantial amounts

B. Undue asset support

Aiding a specially related person or other corporations through the provision of excessive economic benefits by providing or transacting assets such as real estate, securities, intangible property rights, etc., at substantially high or low costs or by providing or transacting such assets in substantial volumes

### C. Undue manpower support

Aiding a specially related person or other corporations through the provision of excessive economic benefits by providing them with manpower at substantially high or low costs or by providing such manpower in substantial number

## ***THE UNITED STATES***

### **The Sherman Antitrust Act, 15 U.S.C. §§ 1-7**

#### Section 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$100,000,000 if a corporation, or, if any other person, \$1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

#### Section 2. Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$100,000,000 if a corporation, or, if any other person, \$1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

### **The Clayton Antitrust Act, 15 U.S.C. §§ 12-27**

#### Section 3. Sale, etc., on agreement not to use goods of competitor

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

### **The Federal Trade Commission Act, 15 U.S.C. §§ 41-58**

#### Section 5. Unfair methods of competition unlawful; prevention by Commission

(a) Declaration of unlawfulness; power to prohibit unfair practices; inapplicability to foreign trade

(1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.

(2) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks, savings and loan institutions described in section 57a (f)(3) of this title, Federal credit unions described in section 57a (f)(4) of this title, common carriers subject to the Acts to regulate commerce, air carriers and foreign

air carriers subject to part A of subtitle VII of title 49, and persons, partnerships, or corporations insofar as they are subject to the Packers and Stockyards Act, 1921, as amended [7 U.S.C. 181 et seq.], except as provided in section 406(b) of said Act [7 U.S.C. 227 (b)], from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.

(3) This subsection shall not apply to unfair methods of competition involving commerce with foreign nations (other than import commerce) unless—

(A) such methods of competition have a direct, substantial, and reasonably foreseeable effect—

(i) on commerce which is not commerce with foreign nations, or on import commerce with foreign nations; or

(ii) on export commerce with foreign nations, of a person engaged in such commerce in the United States; and

(B) such effect gives rise to a claim under the provisions of this subsection, other than this paragraph.

If this subsection applies to such methods of competition only because of the operation of subparagraph (A)(ii), this subsection shall apply to such conduct only for injury to export business in the United States.

(4) (A) For purposes of subsection (a), the term “unfair or deceptive acts or practices” includes such acts or practices involving foreign commerce that—

(i) cause or are likely to cause reasonably foreseeable injury within the United States; or

(ii) involve material conduct occurring within the United States.

(B) All remedies available to the Commission with respect to unfair and deceptive acts or practices shall be available for acts and practices described in this paragraph, including restitution to domestic or foreign victims.

## ***THE EUROPEAN UNION***

### **Article 81 EC Treaty**

(1) The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

(2) Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

(3) The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;

- any decision or category of decisions by associations of undertakings;

- any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

## **Article 82 EC Treaty**

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

## ***JAPAN***

### **Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (Antimonopoly Act): Act No. 54 of 14 April 1947**

#### **Article 1**

The purpose of this Act is, by prohibiting private monopolization, unreasonable restraint of trade and unfair trade practices, by preventing excessive concentration of economic power and by eliminating unreasonable restraint of production, sale, price, technology, etc., and all other unjust restriction on business activities through combinations, agreements, etc., to promote fair and free competition, to stimulate the creative initiative of entrepreneurs, to encourage business activities, to heighten the level of employment and actual national income, and thereby to promote the democratic and wholesome development of the national economy as well as to assure the interests of general consumers.

#### **Article 2**

(5) The term, “private monopolization” as used in this Act means such business activities, by which any entrepreneur, individually or by combination or conspiracy with other entrepreneurs, or by any other manner,

excludes or controls the business activities of other entrepreneurs, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

(6) The term, “unreasonable restraint of trade” as used in this Act means such business activities, by which any entrepreneur, by contract, agreement or any other means irrespective of its name, in concert with other entrepreneurs, mutually restrict or conduct their business activities in such a manner as to fix, maintain, or increase prices, or to limit production, technology, products, facilities, or counterparties, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

(9) The term, “unfair trade practices” as used in this Act means any act falling under any of following items, which tends to impede fair competition and which is designated by the Fair Trade Commission:

(i) Unjustly treat other entrepreneurs in a discriminatory manner;

(ii) Dealing with unjust consideration;

(iii) Unjust inducing or coercing customers of a competitor to deal with oneself;

(iv) Dealing with another party on such conditions as will unjustly restrict the business activities of the said party;

(v) Dealing with another party by unjust use of one’s bargaining position;

(vi) Unjustly interfering with a transaction between an entrepreneur in competition with it in Japan with oneself or a corporation of which oneself is a stockholder or an officer and another transaction counterparty; or, in case such entrepreneur is a corporation, unjustly inducing, instigating, or coercing a stockholder or a director of such corporation to act against the interests of such corporation.

#### Article 3

No entrepreneur shall effect private monopolization or unreasonably restraint of trade.

#### Article 19

No entrepreneur shall employ unfair trade practices.

## GLOSSARY

***Chaebol***: a form of Korean business groups or conglomerate. The word literally means a business group or a trust, and also refers to several large and family-owned business groups that are traditionally supported by the Korean government. *Chaebols* have played a major role in the state's economic development since the 1960s. They own well-known international brands such as *Samsung*, *Hyundai*, and *LG*. *Chaebols* used to cooperate with the Korean government in the field of economic planning. However, after the Monopoly Regulation and Fair Trade Act legislation in 1980, the government has tried to encourage competition amongst *Chaebols* to avoid monopolies in the market. *Chaebols* are very similar to *Zaibatsu* in Japan, which were loose conglomerates. *Chaebols*' affiliates benefited from group membership through sharing intangible and financial resources with other affiliated members. This indicates that various methods of internal business transactions, such as debt guarantee, equity investment, and internal trade, were widely used for the purpose of cross-subsidisation for affiliates. The 30 largest *Chaebols* accounted for 40 per cent of Korea's total output as of 1996. The diversification of the conglomerates through affiliates' indebtedness, by means of internal loans and cross-shareholding, threatened to trigger chain bankruptcies throughout the group, especially in the 1997 Financial Crisis. The dynamic business activities of *Chaebols*' expansion and growth raised efficiency and equity issues about the nature of government intervention, because state economic growth during 1960s and 1970s demanded sacrifices of SMEs and consumers. The *Chaebols*' unlawful activities stressed relative disparities, and triggered the idea of Korean competition policy in 1980.

**Chicago School**: one of the main economic schools which has influenced competition policy. Free market economic thinking has been associated with the Economics Department at University of Chicago. The Chicago School is an academic group of lawyers and economists, focusing on competition policy, whose pro-market, pro-competition, and anti-government views were influential during the 1970s and 1980s in the US. The Chicago School is strongly related with the idea that large firms are likely to have become large from efficient activities, and are therefore more profitable than their smaller competitors. Thus, sanctioning them because they are profitable is essentially the same as to punishing successes or efficiency. This assumes that unregulated actions of private firms are socially benign. The Chicago

School argues strongly against government intervention in markets, in order to promote competition. For that reason, it has tended to argue for lenient enforcement of competition policy, and has suggested that most monopoly problems are created by governments' legal intervention. The Chicago School has also suggested that vertical restraints are harmless.

**Concentration Ratio:** a ratio calculated to explain the degree to which a market or industry is dominated by a small number of firms, or many small firms, based on market shares held by firms. A better ratio for concentration is the Herfindahl-Hirshman Index (HHI) which is given by the sum of the squares of the market shares, i.e.,  $HHI = \sum_n f_n^2$ , where  $f_n$  = market share of firm  $n$ .

**Contestability:** the degree of difficulty with which firms can enter or exit a market. This considers a market made up of a small number of incumbent firms whose market power is constrained by potential entrants. Although the incumbents are few, the market entry may force them to set their prices at a low level. Even in a concentrated market, therefore, it is possible that incumbents can earn only a normal profit. A perfectly contestable market does not have barriers to market entry. Thus, perfect contestability tells us nothing about how many firms currently exist in the market. This theory was originally developed by the economist Baumol in the early 1980s.

**Cross-shareholding:** cross-shareholding was conducive to redundant investment by *Chaebols*. *Chaebols* could often obtain control of their affiliates at a relatively low cost, by using small shares of their own assets to purchase substantial shares of affiliates. Moreover, *Chaebols'* influence over major decisions of the affiliates exceeded their normal holdings through cross-shareholdings.

**Deadweight Loss:** a particular loss in social welfare deriving from an action that has no consequent gain. It refers to total welfare loss from the fact that less output is produced under a monopoly than under perfect competition.

**Developing Country:** a country that has neither reached the stage of economic development characterised by industrial growth, nor a level of national total income which is enough to yield the domestic savings for required investment for further state economic growth.

**Duopoly:** two suppliers of a product or service in a market.

**Economic Power:** the capacity to control economic affairs and the assets of others, and to allocate society's resources. This is power over price. In other words, it is the ability of a firm to raise prices above the competitive level without losing profits. Economic power can derive from a monopolistic or oligopolistic market. This power may be driven unilaterally or jointly, through agreements amongst competitors, or tacit collusion and conscious parallelism.

**Economies of Scale:** factors that allow the average cost of producing a product to fall as output of the product increases.

**Economies of Scope:** factors that make it cheaper to produce a range of related products than to produce each of them individually.

**Efficiency:** there are three kinds of efficiencies as followings:

- (1) Allocative efficiency: existing products and services are allocated to those who value them most, in terms of their willingness to pay. Allocated resources are used in the best way. It refers to the condition of no waste of resources in production. Under the Pareto optimal, price equals marginal cost.
- (2) Productive efficiency: this notion focuses on a particular firm or industry, and considers whether a firm uses its resources in a way that it can exploit economies of scale, existing technology, and reduce all unnecessary costs, so that production is at minimum cost.
- (3) Dynamic efficiency: this concept is the measure of whether a firm has the ability to increase innovation, developing new products or reducing production costs, which can give benefits to consumers and the state economy as a whole.

**Entry Barrier:** anything that puts a potential entrant at a competitive disadvantage. Entry barriers arise from the following four main sources: (1) blocked access by control of supply; (2) scale economy; (3) capital requirements; and (4) product differentiation. The definition of entry barrier has been controversial. However, there are two main theories: (1) Bain's definition of entry barriers as allowing firms to raise prices without inducing entry; and (2)



Stigler's definition, as those costs that a new entrant should face which were not incurred by incumbents when they entered the market.

**Five-Year Economic Development Plans:** the Korean government's policy outcome planned under President Park in the 1960-70s. These plans were made by the economic planning board, the finance ministry, and the ministry of commerce and trade.

**Harvard School:** a school of competition analysis stemming from the structure → conduct → performance (SCP) paradigm developed in the 1930s at Harvard University. This means that the structure of the market leads to firms' performing in certain ways. In short, the number of firms and their market concentration determine the way in which the firms compete. This eventually determines their performance in the market.

**Keiretsu:** a set of companies with interlocking business relationships and shareholdings. This literally refers to 'link', 'affiliate with' or 'connect to'. *Keiretsu* is an informal term often used to mean various forms of inter-firm relationships. These firms tend to have close vertical integration between suppliers and buyers, called *Suichoku* (vertical) *Keiretsu*. There are two types of vertical *Keiretsu*: (1) *Seisan* (production) *Keiretsu*, in which suppliers and manufacturers are deeply related for a single end-product manufacturer, such as in the auto or electronics industries; and (2) *Rutsu* (distribution) *Keiretsu*, in which a single manufacturer supplies goods through a network of wholesalers and retailers that depend on the parent company. *Keiretsu* relationships are complex, multidimensional, and variable across enterprises. The major *Keiretsu* were each centred on one bank, which lent money to the *Keiretsu*'s affiliates. In the same *Keiretsu* group, the relationship between affiliates is much closer than a single supplier and buyer relationship.

**Market Power:** the degree of a firm's influence or control over the price and output in a market. In particular, monopolists often restrict output and charge higher prices than marginal costs.

**Market Share:** either (1) the sales of the product of a firm as a proportion of the sales of the product of the market as a whole, or (2) the sales of a particular product of a firm compared with the total sales for the others.

**New Economy:** narrowly, new business activities created by information and communications technology including computer hardware and software, telecommunications and other aspects of the digital revolution, such as the internet.

***Ordoliberalism:*** the idea of influencing competition policy to protect individual economic freedom of action as a value in itself, or *vice versa*, the restraint of undue private economic power. The principle of this theory was humanist rather than efficiency, or other pure economic concerns. It envisioned a society in which individuals were as free as possible from government intervention. From this perspective, private monopoly power threatens the competitive process, and the primary function of competition policy was to eliminate it, or at least prevent its harmful effects. In particular, the EC competition law played a central role in *Ordoliberal* theories of economic organisation. *Ordoliberalism* is not just a school of competition or economic theory, but an entire political and economic philosophy, due to its important implications for competition policy. This approach to competition policy leads to the protection of competitors and small firms, regardless of the effects on efficiency, rather than the protection of competition. It focuses on the freedom of market entities entering and competing in the markets. Korea seems to adopt *Ordoliberalism* although its implementation is not clear.

**Perfect Competition:** a perfectly competitive market has six main characteristics: a large number of buyers and sellers; perfect knowledge; identical products; firms' independent actions; free entry and exit; firms' ability to sell as much output as they wish. Amongst these, there are four major conditions for perfect competition; (1) an absolutely homogenous product providing the same price; (2) a seller's output increasing or decreasing, or its exit from the market does not affect the decisions of other sellers in that market; (3) all sellers have the same access to necessary input; and (4) all market entities have good knowledge of price, output and other information about the market. The closer a market comes to fulfilling these conditions, the more competitively it will perform.

**Post-Chicago School or New Industrial Organisation Economics:** a modern industrial organisation theory school whose theories focus less on market structure and more on strategic issues, and the strategic behaviour of firms based on game theory.

**Rent Seeking Behaviour:** a behaviour that improves the welfare of a particular entity in the market at the expense of the welfare of someone else. The most extreme case is that of protection of a certain group's interest, which betters the group members without ensuring any welfare-enhancing outcome.

**Transaction Cost:** a cost incurred in making an economic transaction. There are a number of transaction costs, such as search and information costs, bargaining costs, policing and enforcement costs. A transaction cost analysis often applies in vertical arrangements. Firms at up- and downstream level could be used to bring activity at successive interfaces into adjustment. Such an adjustment of contracts can be costly. The basic presumption of this incurred cost is the transaction cost. The transaction cost approach is concerned with the costs of running the economic system, especially the costs of adapting efficiently to uncertainty from negotiating new agreements.

***Zaibatsu*:** business conglomerates whose influence and size allowed for control over significant parts of the Japanese economy. This term was commonly used until the end of the Second World War. It was often used as a political expression referring to the estate of wealth. It refers to the large family-owned banking and industrial combines in Japan. *Zaibatsu* such as *Mitsubishi*, *Mitsui*, *Sumitomo*, and *Yasuda* are the most historically significant *Zaibatsu* groups, having roots stemming from the *Edo* period of Japanese history. Most of the *Zaibatsu* were founded by political merchants who had close connections with the *Hanbatsu* (clansmen) of the early *Meiji* government. These *Zaibatsu* received a powerful incentive from the Japanese military and naval programmes. During the 1910s and 1940s, *Zaibatsu* increased their strength. There were six large business groups: *Mitsubishi*, *Mitsui*, and *Sumitomo* which were based on the pre-war *Zaibatsu*, and the others, *Fuyo*, *Sanwha*, and *Ichikan* which were the new conglomerates rapidly developing in the post-war period.

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