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Yong Lim

Geeyoung Min

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Competition and Corporate Governance: Teaming Up to Police Tunneling

***Yong Lim*[†] *& Geeyoung Min*[*]**

Abstract: Is the extraction of private benefits by the firm's controllers only an issue for minority or non-controlling shareholders? Korea's treatment of such conduct (often called "tunneling") provides useful insights to this question. Tunneling by controlling shareholders, which has traditionally been the concern of corporate governance law and policy in the U.S., is further subject to scrutiny under competition law (Undue Support Clause) in Korea. This Article discusses a real world example of an intersection between competition law and corporate governance policy from a comparative perspective. The history of the Undue Support Clause challenges the common perception that a corporate governance malady has nothing to do with competition law (or vice versa). Although this is not a complete survey of all the intricacies that can arise when competition and corporate governance intersect with one another, Korea's experience with the Undue Support Clause provides an invaluable opportunity to reevaluate the relationship between the two policies and draw valuable insights for other jurisdictions, including the U.S., that tend to turn a blind eye towards harm inflicted outside of the firm by tunneling.

[†] Associate Professor, Seoul National University

[*] Research Assistant Professor of Law, University of Virginia School of Law; Postdoctoral Fellow in Corporate Law and Governance at Ira M. Millstein Center at Columbia Law School.

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I. INTRODUCTION

Korean Air exclusively sources its in-flight magazine ad services and online duty free sales through a company named Cybersky Co. Ltd (Cybersky). Cybersky is a private company wholly owned by the three children of the current Chairman and patriarch of Korean Air's owner family. Fresh out of the "nut rage" scandal,[1] the family is now facing suspicion that it has privately benefited over the years from preferential dealings between Cybersky and Korean Air and its other affiliates in the conglomerate.[2]

Meanwhile, halfway around the world, Nordstrom Inc. is facing its own set of allegations surrounding jets operated by the company. According to a recently filed derivative suit, the company has been operating a large fleet of private jets to the benefit of the Nordstrom family and, concomitantly, a loss to other shareholders.[3]

While it remains to be seen whether the allegations are true, the extraction of wealth from the firm by its controlling shareholders and managers (controllers), or "tunneling" as it is commonly referred to, is a well-known ailment in the corporate governance pathology.[4] The conventional toolkit for preventing or treating its symptoms is comprised of rules sprinkled throughout a diverse set of laws and regulations. As partly showcased in the Nordstrom derivative suit above, these generally include corporate law, securities and accounting regulations, stock exchange rules, tax law, bankruptcy law, insolvency law and fraudulent conveyance law.[5]

Korea also has a statute that restricts tunneling activity by forbidding improper wealth transfers from a firm to another party, making it punishable not only by administrative surcharges, but also by criminal fines and imprisonment. To be clear, this statute is not the sole anti-tunneling law in Korea, and examples of criminal punishment of corporate governance

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[1] *'Nut rage' incident could result in sanctions against Korean Air*, THE GUARDIAN (Dec. 16, 2014, 2:41 PM), http://www.theguardian.com/world/2014/dec/16/nut-rage-incident-sanctions-korean-air.

[2] Sung-Hee Lee, *Cho Hyun Ah deung Daehanhanggong 3 Nammaeeui 'Saguiup' Cybersky: Ilgam Molajugi, Nodongryok Chakchi Nonlan* [*Cybersky, The Private Company of Hyun-Ah Cho and the Three Korean Air Siblings. . . Allegations of Funneling of Business and Exploitation of Man Power*], KYUNGHYANG BIZNLIFE (Dec. 22, 2014, 6:00 AM), http://bizn.khan.co.kr/khan_art_view.html?artid=201412220600385&code=920100&med=khan (S. Kor.).

[3] Jonathan Randles, *Nordstrom Hid Cost of Family's Plane Rides, Shareholders Say*, LAW360 (Mar. 13, 2015, 3:06 PM), http://www.law360.com/articles/631017/nordstrom-hid-cost-of-family-s-plane-rides-shareholders-say.

[4] There is no universal definition of "tunneling." Related party transactions, even if they raise potential conflicts of interest, are not always harmful to the corporation. Tunneling, as used in this Article, describes the "transfer of assets and profits out of firms for the benefits of those who control them" that negatively affect the firm's value. Simon Johnson et al., *Tunneling*, 90 AMER. ECON. REV. 22, 22 (2000).

[5] Vladimir Atanasov et al., *Law and Tunneling*, 37 IOWA J. CORP. L. 1, 9–10 (2011).

law violations can be easily found in other jurisdictions as well. What makes this otherwise less remarkable statute rather peculiar is not so much its content, but its placement. The statute is embedded in Chapter V of Korea's primary legislation on competition, i.e., the Monopoly Regulation & Fair Trade Act (MRFTA). The authors are not aware of any other jurisdiction around the world that similarly deploys competition law[6] as part of its corporate governance toolkit against tunneling activities.[7]

Enlisting competition law as a tool of corporate governance would strike many as an odd choice, to say the least. At the heart of corporate governance lies the agency problem, which percolates through the internal workings of the firm.[8] By contrast, the concern of antitrust is market competition, which involves the firm's external interactions in the marketplace. The two legal regimes, however, are not completely exclusive. The firm acts within the boundaries of the market, and the market environment informs the structure and behavior of the firm. Antitrust policy could therefore have an impact on corporate governance to the extent that market competition disciplines the firm's agents.[9] But this does not seem to provide sufficient reason for competition policy to wade directly into corporate governance issues. In fact, can a corporate governance problem ever become a proper concern of competition policy? Even if that were the case, could a law that focuses on the pathologies of the market provide an effective cure for an internal ailment of the firm?

Korea's unique application of competition law as a potential cure for corporate governance problems serves as a policy experiment, providing a rare opportunity to examine these and related questions based on real world experience.[10] This Article is an attempt to explore whether and when

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[6] For purposes of discussion, competition (or antitrust) and corporate governance are posited as two separate (but potentially interrelated) regimes or policies. When the Article refers to competition *law* or corporate governance *law*, it points to the specific statutes, rules and regulations which uphold each respective legal regime or policy.

[7] *See* OECD, PUBLIC ENFORCEMENT AND CORPORATE GOVERNANCE IN ASIA: GUIDANCE AND GOOD PRACTICES 9–11 (2014), http://www.oecd-ilibrary.org/finance-and-investment/public-enforcement-and-corporate-governance-in-asia_9789264217409-en, which identifies major pillars that uphold the corporate governance legal structure in different jurisdictions. The jurisdictions covered by the report are Bangladesh, China, Chinese Taipei, Hong Kong, India, Indonesia, Korea, Malaysia, Mongolia, Pakistan, the Philippines, Singapore, Thailand and Vietnam. The jurisdictions utilize a mix of corporate law, securities regulations, and corporate governance codes and guidelines. Only Korea, however, includes competition law as a pillar of its corporate governance legal system.

[8] *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

[9] *See* Daniel A. Farber & Brett H. McDonnell, *Are Efficient Antitrust Rules Always Optimal?*, 48 ANTITRUST BULL. 807, 815–23 (2003) (discussing the possible effects antitrust policy may have on corporate governance through the promotion of competition).

[10] Korea's unique application of competition law to issues traditionally viewed as those pertaining to corporate governance has been noted in the past from several different perspectives. *See, e.g.*, Haksoo Ko, *Dealing with Corporate Self-Dealing in Korea: A New Institutional Law and Economics Approach*,

competition law might play a constructive role in the area of corporate governance by looking at Korea's experience. A major point of divergence in regulating tunneling between Korea and other jurisdictions, including the U.S., is how to understand the harm caused by the conduct. For example, should the law be primarily concerned with harm inflicted upon the constituents of the firm (shareholders and possibly other stakeholders), or should it also be concerned with the welfare of consumers in the market? Because each jurisdiction must cope with the peculiarities of its own social and market environment, the right answer may differ by jurisdiction. However, this Article shows that, at least under certain circumstances, tunneling can impact not only the welfare of those inside the firm (shareholders), but also outside of it (consumers in the market), setting the stage for a collaborative effort between competition law and corporate governance. As Korea's experience shows, such collaboration can be beneficial, but will also face challenges such as identifying cognizable harm to consumers as opposed to shareholders.

Part II of the Article will introduce the MRFTA's statute and its legislative history in order to lay down the groundwork for the analysis to follow. In this process, we will also examine a threshold question—whether the statute's inclusion in the MRFTA is a genuine attempt to enlist competition law as part of the corporate governance arsenal, and thus, worthy of closer examination, or simply an idiosyncratic and thus, coincidental choice of placement. In fact, the statute has drawn sharp criticism in Korea from both competition law and corporate law experts, who argue that there is no basis for competition law to interject itself into corporate governance affairs. Accordingly, in Part III, we take a closer look at the relationship between antitrust and corporate governance to examine whether the choice to utilize competition law has any basis as a matter of policy. Then, in Part IV, we will discuss what Korea's experience teaches us regarding both the advantages and limitations of competition law's foray into the corporate governance world. Finally, Part V concludes.

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17 ASIA PAC. L. REV. 201, 213–18 (2009) (arguing from a transaction costs basis that Korea's approach of regulating corporate self-dealings with competition law is justified); Nansulhun Choi & Sang Yop Kang, *Competition Law Meets Corporate Governance: Ownership Structure, Voting Leverage, and Investor Protection of Large Family Corporate Governance in Korea*, 2 PKU TRANSNAT'L L. REV. 411, 411 (2014) (discussing the merits of a holding company system over circular shareholding in terms of mitigating agency costs in the case of large Korean conglomerates) (China). This Article is distinct from the existing literature in the sense that it focuses directly on both the theoretical and practical underpinnings of utilizing competition law as a corporate governance policy tool and extending the findings to other jurisdictions such as the United States

II. THE UNDUE SUPPORT CLAUSE AND ITS FORAY INTO CORPORATE GOVERNANCE

A. Overview

Chapter V of the MRFTA, Korea's primary competition law, consists of five articles. The statute of concern for purposes of our discussion is Article 23.[11] Article 23, which is said to have its roots in Section 5 of the U.S. Federal Trade Commission Act, deals with "unfair trade practices."[12]

Paragraph (1) of Article 23 lists seven specific types of unfair trade practices, followed by a catch-all provision. The seventh prohibited practice is called "undue support."[13] The current language of the statute is as follows:

> Article 23. Prohibition of Unfair Trade Practices
> (1) An undertaking shall not itself, or have an affiliated company or another undertaking, engage in any practices that fall under the following subparagraphs and raise the concern of harming fair trade (hereinafter, referred to as "unfair trade practices").
> . . .
> (vii) Unduly supporting a Specially Related Party[14] or another

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[11] Article 23-3 prohibits retaliatory actions against parties who have complained to the Korea Fair Trade Commission (KFTC) or are cooperating with it regarding investigations into such practices. Dokjeom-Gyuje Mit Gongjeong-Georae-e Gwanhan Beobryul [Monopoly Regulation & Fair Trade Act], Act No. 3320, Dec. 31, 1980, *as amended by* Act No. 11937, July 16, 2013 (S. Kor.).
Articles 24 and 24-2 provide for corrective measures and administrative surcharges against violations of the Chapter's articles. *Id.*

[12] Jung Ha Lim, *Budang-Jeewon-Hangwee Gyoojae-e Gwanhan Noneui – Budang-Jeewon-Hangwee-eui Sungreep-Yokun-eul Joongshim-euro* [*Review of Restrictions on Undue Support Practices – Focusing on Legal Requirements for Undue Support Practices*], 10 ECON. L. no. 2, 2008, at 45, 47 (2012). Article 23 of the MRFTA was modeled after the Unfair Trade Practices provisions of the Japanese Act on Prohibition of Private Monopolization and Maintenance of Fair Trade, Shiteki-dokusen no Kinshi oyobi Kōseitorihiki no Kakuho ni Kansuru Hōritsu, Law No. 54 of 1947, art. 19, which in turn was based on Section 5 of the U.S. Federal Trade Commission Act of 1914, 15 U.S.C §§ 41–58 (2015). ETSUKO KEMEOKA, COMPETITION LAW AND POLICY IN JAPAN AND THE EU 58 (2014). To be sure, Section 5 of the Federal Trade Commission Act prohibits "unfair methods of competition." 15 U.S.C. § 45.

[13] The KFTC has often referred to the prohibited type of practice as "undue internal transactions." *But see* Bong-Eui Lee, *Dokjeom-Gyuje Beobsang Budang-Jeewon-Hangwee – Beobgwa Jungchek-ui Johwa Shido* [*A Study on Unfair Supporting Practices – An Attempt to Harmonize Law and Policy*], 27 J, KOREAN COMPETITION L. 228, 229 n.4 (2013) (noting that undue internal transactions and undue supporting activities are different concepts under the MRFTA and should be clearly distinguished from one another) (S. Kor.).

[14] The MRFTA and its underlying rules provide detailed definitions of Specially Related Parties. Act No. 3320, Dec. 31, 1980, *as amended by* Act No. 11937, July 16, 2013, art. 7(1) (S. Kor.); Dokjeom-Gyuje Mit Gongjeong-Georae-e Gwanhan Beobryul Shihaengryung [Enforcement Decree of the Monopoly Regulation and Fair Trade Act], Presidential Decree No. 25840, Dec. 9, 2014, arts. 3(a), 11 (S. Kor.). For purposes of this Article, Specially Related Parties of an undertaking can be broadly

> company through either of the following acts:
> (a) providing advanced payments, loans, manpower, real estate, commercial notes, goods, services, intangible property, etc., to a Specially Related Party or another company, or transacting on considerably advantageous terms therefor;
> (b) transacting with another undertaking through a Specially Related Party or another company that does not have a substantial role in the transaction, despite it being considerably advantageous to directly transact with such undertaking.

Article 23(1)(vii)(a) prohibits a firm from harming fair trade by providing support to another party (either a person or company, affiliated or non-affiliated) via transfer of various resources or transacting such resources on terms that are considerably favorable to the other party.[15] On its face, the scope of the statute is not limited to tunneling activities, since its reach extends to wealth transfers not only to the controllers of the firm or affiliates but to non-affiliated third parties as well.[16] However, the statute has primarily been enforced against tunneling occurring at Korea's large family-controlled conglomerates, or *chaebols*.[17]

Article 23(1)(vii)(b) prohibits a specific type of tunneling called "tolling," where a party (usually one affiliated with the controllers) is inserted into the chain of transaction without a proper business reason, resulting in its extraction of part of the value generated by the transaction.[18]

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understood as a party (whether a person or a company) that has effective control over the undertaking (through shareholding or other means of control) or those with certain familial relationships with such party (in the case of a person).

[15] Before a 2013 amendment of the MRFTA, the statute required that the terms be "significantly" advantageous to the supported party. The amendment lowered the threshold to "considerably" with the intent of expanding the statute to capture less-than-significant but nevertheless favorable dealings and lower the burden of proof for the KFTC in prosecuting Article 23(1)(vii). *See generally* Yunjeong Kim, *Teuksoo-Gwangyein-e Daehan Budang-Eeik-Jaegong-Hangwee Gyuje-eui Beobjuk Jengjumkwa Gaesun-Gwajae* [*Issues and Improvements for Regulation of Undue Provision of Benefits to Specially Related Persons*], 29 J. KOREAN COMPETITION L. 80 (2014) (providing a more detailed explanation on the history and background of the 2013 amendment) (S. Kor.).

[16] Act No. 3320, Dec. 31, 1980, *as amended by* Act No. 11937, July 16, 2013 (S. Kor.). On its face, the statutory language condemns virtually any wealth transfer (whether cash, assets or equity) to another party on terms that considerably deviates from an arms-length transaction, regardless of the relationship between the parties.

[17] KFTC, GONGJEONG GEORAE UIWONHUI-EUI 30NYEONSA [A HISTORY OF THREE DECADES AT THE FAIR TRADE COMMISSION] 449 (2011) [hereinafter KFTC, A HISTORY] (S. Kor.). *Chaebols* refer to powerful Korean conglomerates dominated or controlled by a Chairman and his or her family, most of whom have played a significant role in the development and rise of the Korean economy. Examples of easily recognizable *chaebol* names include Samsung, LG, and Hyundai Motors.

[18] An example may help the reader. Companies X and Y wish to transact with one another. Instead of directly transacting with Y, X inserts Z into the chain of transaction despite the fact that Z will not be

Article 23(2) makes the supported party liable for a violation of Article 23(1)(vii) in addition to the supporting party.[19] Both Articles 23(1)(vii)(b) and 23(2) were added to Article 23 through an amendment of the MRFTA in 2013. The amendment also added Article 23-2, which prohibits the provision of certain improper benefits to specially related parties.[20]

Due to their recent introduction into the MRFTA, no enforcement cases have yet been brought under Articles 23(1)(vii)(b) and 23-2. Accordingly, this Article will primarily focus on Article 23(1)(vii)(a), the "Undue Support Clause."

B. The Undue Support Clause as an Intersection of Corporate Governance and Competition

Before we dissect the Undue Support Clause to examine whether competition law can play a constructive role in the corporate governance legal system, we must first confirm that the statute truly represents a genuine intersection between corporate governance and competition.[21]

1. The Statute as a Part of the Corporate Governance Legal System

(a) The Rise of the *Chaebols* and Their Economic Power

The *chaebols* were instrumental in implementing industrial policy during Korea's post-war development, particularly from the 1960s onward.[22] In this capacity, the *chaebols* were also the beneficiaries of

providing any meaningful incremental value to the transaction. Z is a company owned by X's controllers, and will be taking a cut of the margin while serving as a pass-through (toll booth) for the transaction, leading to the extraction of wealth from X or Y to Z (and eventually to Z's controllers). According to the taxonomy provided by Atanasov, tolling would mainly occur in the form of cash flow tunneling. Atanasov et. al., *supra* note 5, at 5–6, Again, as in the case of Article 23(1)(vii)(a), the language does not limit the scope of the statute to tunneling, and broadly condemns the existence of a party in the transaction chain that does not have a reasonable justification for being included in the chain or does not provide value commensurate to the compensation it receives for its services.

[19] The provision's language is as follows: "Neither a Specially Related Party or another company shall receive support from another undertaking when there is a concern that such support shall violate Paragraph (1)(vii) above." Act No. 3320, Dec. 31, 1980, *as amended by* Act No. 11937, July 16, 2013 (S. Kor.).

[20] Article 23-2 was enacted based on criticism that Article 23(1)(vii) was ineffective in preventing certain equity tunneling to members of the *chaebol*'s owner-family and "funneling of business" type transactions. Kim, *supra* note 15, at 81–86.

[21] This question is worth asking because the decision to place a statute in a particular type of law may not necessarily be based on the statute's relevancy to the law's purpose or intent. *See* Atanasov et al., *supra* note 5, at 9–10 (noting the need to formulate a taxonomy of tunneling related rules that do not depend on idiosyncratic decisions of where to place a particular rule).

[22] *See* Michael A. Witt, *South Korea: Plutocratic State-Led Capitalism Reconfiguring*, *in* THE OXFORD HANDBOOK OF ASIAN BUSINESS SYSTEMS 2 (Michael A. Witt & Gordon Redding eds., 2014)

government aid and preferential regulatory treatment which allowed, and in some cases actively facilitated, the acquisition of significant market power in segments where they were active.[23] By 1980, the share of the top thirty *chaebols* amounted to 36% of the national economy as measured by their share of turnover in the manufacturing and mining sector.[24] Perhaps unsurprisingly, a significant portion of the nation's economy at the time operated in markets controlled by monopolies or oligopolies.[25] In 1986, a host of regulations aimed at curbing economic concentration were introduced into Chapter III of the MRFTA because the concentration of economic power into the hands of the *chaebols* was perceived as a threat to the sustainable and balanced development of the nation's market economy.[26] These included targeted restrictions against the *chaebols* regarding the establishment of holding companies, direct cross-shareholdings, ceilings on the total possible amount of investment, and the exercise of voting rights by affiliates in the financial and insurance industries.[27]

Despite these attempts to stem the tide of economic concentration into the hands of the *chaebols*, the growth of their economic power and influence continued unabated throughout the following decade. By 1995, the top five *chaebols* accounted for more than 25% of the nation's economic activity, while the top thirty *chaebols*' share of activity increased to 40.7%.[28] During this period, the *chaebols* also expanded their reach into

(distinguishing the Korean development model with the Japanese model based on its reliance on the *chaebols*, and describing the business as a "subservient tool" for the governments' economic policy); KFTC, A HISTORY, *supra* note 17, at 160.

[23] Jin-Young Jung, *Post-Crisis Restructuring of the Corporate Governance of Korean Companies*, 13 CORP. GOVERNANCE 3, 5–6 (2013).

[24] KFTC, A HISTORY, *supra* note 17, at 245.

[25] *See* Meong-Cho Yang, *Competition Law and Policy of the Republic of Korea*, 54 ANTITRUST BULL. 621, 622 (2009) (citing statistics by the Economic Planning Board (EPB), which show that monopolies or oligopolies manufactured 89% of industrial goods produced in the country in 1979). Prior to an amendment of the MRFTA in 1990, the KFTC served as an advisory body for the minister of the EPB.

[26] KFTC, A HISTORY, *supra* note 17, at 160–61; Seung-Wha Chang & Youngjin Jung, *Korea's Competition Law and Policies in Perspective*, 26 NW. J. INT'L L. & BUS. 687, 692–93 (2006).

[27] These restrictions were introduced in Chapter III of the MRFTA in 1986 under the added title of "Control of Economic Concentration." Act No. 3320, Dec. 31, 1980, *as amended by* Act No. 3875, Dec. 31, 1986 (S. Kor.). Article 1 of the MRFTA had already mentioned the "prevention of excessive economic concentration" as one of the law's primary enforcement objectives. However, it was only from the 1986 amendment that the MRFTA incorporated specific rules targeting economic concentration. KFTC, A HISTORY, *supra* note 17, at 122. The Korean Constitution was also amended in 1987 to explicitly provide the government with the authority to pursue policies that restrain economic concentration and dispense with any constitutional doubts about laws that purported to do so. DAEHANMINKUK HUNBEOB [HUNBEOB] [CONSTITUTION] art. 119 (S. Kor.).

[28] KFTC, A HISTORY, *supra* note 17, at 245. The figures are measured by the *chaebol*'s share of turnover in the manufacturing and mining sector.

various markets through the acquisition or establishment of affiliated companies. In 1987, the total number of companies affiliated with the top thirty *chaebols* was 493. A decade later, that number had increased to 819.[29] The concentration of economic power was further reflected in the *chaebols'* market power. As of 1997, one could find at least one of the top thirty *chaebols* among the top three competitors in 83.4% of the product markets where they were active.[30] They were the number one market leader in 41% of such markets.[31]

(b) The Enactment and Subsequent Introduction of Corporate Governance Considerations into the Undue Support Clause

The Undue Support Clause was introduced into the MRFTA against this backdrop.[32] At the time of the statute's enactment, inter-group (affiliated) dealings among the large *chaebols* constituted nearly 25% of their total turnover.[33] There were concerns that the significant volume of affiliated transactions supported the expansion and consolidation of the *chaebol*'s economic power. Such affiliated transactions were perceived as often being carried out to maximize the socio-economic prestige and influence wielded by the *chaebol* family rather than to maximize shareholder value and efficiency.[34]

Thus the stated primary legislative goal of the Undue Support Clause was to control economic concentration.[35] While the perceived problems of affiliated dealings likely reflected a breakdown in corporate governance, such concerns—like harm to creditors and minority shareholders—were not explicitly mentioned or discussed in the legislative documents.[36]

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[29] *Id.* at 246. The top thirty *chaebols* on average were active in 19.7 different businesses.

[30] *Id.*

[31] *Id.*

[32] The MRFTA was amended on Dec. 30, 1996, and the amendments including the Undue Support Clause came into effect as of Apr. 1, 1997. Act No. 3320, Dec. 31, 1980, *as amended by* Act No. 5235, Dec. 30, 1996 (S. Kor.).

[33] Byung-Duk Chung, *Gongjeong-Georae Beobsang-eui Gieob Jibdan Gyuje-eui Hyeonhwang-gwa Gwaje* [*The State and Challenges of the Regulation of Business Conglomerates under the Fair Trade Act*], 36 DANKOOK L. REV. 777, 788 (2012) (S. Kor.); KFTC, 9908Joeui1245 (Decision No. 99-213), Oct. 28, 1999 (S. Kor.).

[34] KFTC, A HISTORY, *supra* note 17, at 261.

[35] Kim, *supra* note 15, at 82 (referring to a 1996 report by the Public Administration Committee of the National Assembly). The report also included assisting the shift from a monopolistic or oligopolistic market structure to a more competitive one, strengthening the national economy's overall competitiveness as a purpose of the amendment.

[36] Jeong Seo, Budang-Jeewon-Hangwee Gyuje-ae Gwanhan Yeongu [A Study on the Regulation of Undue Support] 15 (2008) (unpublished Ph.D. dissertation, Seoul National University) (S. Kor.). Rather, at the time of the statute's enactment, the primary concern with undue supporting seems to have been its role in the prevention or delay of the exit of an inefficient or failing affiliate, and its utilization as a tool to degrade or foreclose rivals of the supported affiliate from the market. Lim, *supra* note 12, at 49; Lee,

However, due to the nature of the targeted activities, the regulation of undue support had ramifications for corporate governance. This was particularly evident in the cases where undue support seemed more oriented towards expanding the size and scope of the *chaebol* (thus boosting the prestige of its owner-family controllers) rather than the interests of shareholders. That left the door open for possible future injections of corporate governance considerations into the statute, which is precisely what happened in the wake of the Asian financial crisis in 1997.[37] The 1997 crisis exposed a slew of problems with the management and corporate governance of *chaebols*. In response, the authorities increasingly began to view the Undue Support Clause as a part of the corporate governance toolkit. The KFTC's regulation of undue support among *chaebol* affiliates became an integral part of the Korean government's post-crisis corporate restructuring and reform program.[38] This shift in the underlying perception of the role and purpose of the Undue Support Clause culminated in a 2003 Korean Constitutional Court decision stating that one of the statute's goals was to prevent activity that "degraded corporate transparency and harmed the interests of shareholders (particularly minority shareholders) and creditors."[39]

While the court's statement has been the subject of much criticism,[40] it at least seems clear that the Undue Support Clause was enacted to intervene into the affairs of the *chaebols*, which includes their corporate governance.[41] As we shall later see, deciding the proper extent and scope of

supra note 13, at 229.

37 Seo, *supra* note 36, at 11.

38 KFTC, A HISTORY, *supra* note 17, at 426–30. When the maximum administrative surcharge amount for a violation of the Undue Support Clause was increased from 2% to 5% of the supporting company's relevant revenue in late 1999, one of the main reasons cited for the increase was the facilitation of the chaebols' corporate restructuring. Jin Yul Ju, *Gongjeong-Georae Beobsang Budang Jeewon Hangwee Gyuje-ae Daehan Bipanjuk Gochal* [*A Critical Analysis of the Regulation of Undue Support under the Fair Trade Act*], 53 SEOUL L.J. 637, 641 (2012) (referring to a 1999 report by the National Policy Committee of the National Assembly) (S. Kor.).

39 Constitutional Court [Const. Ct.], 2001Hun-Ka25, Jul. 24, 2003, (15-2(A) KCCR 1) (S. Kor.). The court mentioned three other harms stemming from undue supporting: (i) degrading the proper functioning of the market by unduly foreclosing independent (non-affiliated) competitors or deterring new market entry by allowing the survival or preventing the exit of failing and inefficient affiliated companies, (ii) causing economic concentration by increasing the monopoly power of affiliated companies within large conglomerates through the mutual generation of monopolistic or oligopolistic rents, and (iii) leading to systemic risks for the entire conglomerate and its member companies as a result of the dispersion or draining of the core competencies of the conglomerate's healthy companies toward failing affiliates. *Id.*

40 *See, e.g.*, Jeong Seo, *Budang Jeewon Hangwee Gyuje, Manneung Chiyoochaeg-inga? Mokjeog-gwa Sudan-eui Jeonghabseong-e Gwanhan Geomto* [*Is the Regulation of Undue Support a Panacea? – A Review of the Consistency between its Objectives and Methods*], 3 YONSEI GLOBAL BUS. L. REV. 31, 39–41 (2011) (S. Kor.).

41 *See also* Chang & Jung, *supra* note 26, at 694 (stating that the Korean authorities consider

such intervention has been one of the core issues in the enforcement of the statute.

2. The Statute as a Part of Competition Law

While we have established the Undue Support Clause's relevance to corporate governance, we must still confirm that the statute constitutes a part of competition law.[42]

The fact that the statute is located in competition law does not make the answer a foregone conclusion. As discussed above, the statute was enacted with the primary objective of controlling economic concentration. While economic concentration and the resulting market structure certainly have an impact on competition, the control of economic concentration seems more apt as a subject of industrial or economic policy rather than a goal of antitrust.[43] Other rules in Chapter III[44] of the MRFTA that purport to combat economic concentration, which include restrictions on cross-shareholdings, investments, voting rights, holding companies, and disclosure obligations for self-dealing type transactions, are often found in and could readily be placed in other types of law (e.g., corporate law and securities regulations).[45] This may prompt some to question whether the MRFTA's inclusion of the Undue Support Clause might have been the result of an idiosyncratic choice of placement, rather than a recognition of the statute's relevance to competition policy.

In fact, the legislative proposal for the Undue Support Clause had originally placed the statute in Chapter III in line with its stated purpose to regulate economic concentration. However, following strong objections from the *chaebols* who did not wish to see another rule added to Chapter

corporate governance issues and economic concentration to be closely related).

[42] The policy goals of the MRFTA may include objectives that exceed the scope of U.S. antitrust law. The MRFTA's objectives encompass considerations of fairness, protection of small-and-medium-sized enterprises, and even industrial policy. OH-SEUNG KWON, GYUNGJAEBEOB [ECONOMIC LAW] 79–86 (11th ed. 2014) (S. Kor.). The question here, however, is not whether the MRFTA might include the improvement of corporate governance as an objective, but whether the Undue Support Clause's purpose is to protect competition as commonly understood as the proper objective of competition law.

[43] *See* Seo, *supra* note 40, at 43–44. The legislative goals of the Sherman Act has also been the subject of debate in the past, and commentators have pointed to the fear against "bigness" as one of the ideological driving forces behind the enactment of the law. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE, 57–61 (4th ed. 2011). Modern antirust policy in the U.S., however, has moved on from concerns of bigness to the protection of consumer welfare enhancing competition.

[44] The title of Chapter III of the MRFTA is "Restriction of Business Combinations and the Control of Economic Concentration."

[45] The KFTC itself acknowledged as early as 2003 that MRFTA provisions which directly regulated economic concentration could cede their role to corporate and other laws once corporate governance improved and market discipline became effective. KFTC, A HISTORY, *supra* note 17, at 432; Chang & Jung, *supra* note 26, at 694.

III, the statute was eventually incorporated into Article 23 in Chapter V.[46] The placement of the statute under Article 23 and its categorization as a type of unfair trade practice required that the undue support cause "harm to fair trade," which according to the courts is ultimately caused by restricting competition in the relevant market of the support's recipient.[47] The courts have also refused to find a violation in cases where there is simply no nexus to market competition even on a conceptual level.[48] The Undue Support Clause's placement in Chapter V of the MRFTA, and the courts' subsequent interpretation of the statute, at least conceptually, as one regulating anticompetitive conduct, confirms the statute as a part of competition law.

* * *

In sum, we have met the threshold of identifying a genuine case of an intersection between competition law and corporate governance law in the Undue Support Clause. Now we must examine whether competition policy has anything to do with corporate governance policy in the first place. If the answer is no, we have a schizophrenic statute at odds with itself. If the answer is yes, the question then becomes what are the common grounds between the two policies.

III. COMPETITION AND CORPORATE GOVERNANCE: COMPLETE STRANGERS, CORDIAL NEIGHBORS, OR POSSIBLE COLLABORATORS?

A. The Not-so-Informative Link of *X-Inefficiency*

Competition policy's effect on corporate governance, and *vice versa*, is a topic that has not garnered much attention.[49] One reason for this may be the fact that modern antitrust policy has narrowed its focus on consumer welfare effects while trying to avoid getting entangled in other social and

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[46] Ho Young Lee, *Gyeongjeryuk-jibjoong Eokje-leul Weehan Gyeongjaengbeobjeog Gyuje-eui Yooyongseong-gwa Hangye* [*The Usefulness and Limitations of Competition Law's Regulation of Economic Concentration*], 24 HANYANG L. REV. 153, 157 & n.9 (2007) (S. Kor.).

[47] Supreme Court [S. Ct.], 2001Du6364, Sept. 24, 2004 (S. Kor.); Supreme Court [S. Ct.], 2001Du7220, Mar. 12, 2004 (S. Kor.).

[48] *See* Supreme Court [S. Ct.], 2004Du2219, Jan. 27, 2005 (S. Kor.); Supreme Court [S. Ct.], 2001Du6364, Sep. 24, 2004 (S. Kor.).

[49] Farber & McDonnell, *supra* note 9, at 815 (noting the competition policy's effect on corporate governance issues is a topic that has "received less attention than it deserves"). Other examples of recent rare forays into the relationship of antitrust policy and corporate governance include a comparative study on competition policy's implications for state-owned enterprises, D. Daniel Sokol, *Competition Policy and Comparative Corporate Governance of State-Owned Enterprises*, 2009 BYU L. REV. 1713 (2009), and corporate governance law's possible role in strengthening antitrust compliance, Jesse W. Markham, Jr., *The Failure of Corporate Governance Standards and Antitrust Compliance*, 58 S.D. L. REV. 499 (2013).

policy objectives.[50] Another reason for this from antitrust jurisprudence may be the intraenterprise conspiracy or single economic entity theory. In the U.S., this theory has been espoused in *Copperweld*[51] and its progeny, which exclude most agreements between affiliates or enterprises under common control from antitrust scrutiny under Section 1 of the Sherman Act.[52]

That being said, competition's potential for reducing managerial slack on the part of the corporation's agents has not gone unnoticed. It is well recognized that product market competition can function as another disciplinary mechanism against incompetent managers, and competition can also supplement other corporate governance mechanisms by better exposing inefficient managers at the corporation when they are surpassed by more efficient rivals.[53] The relationship between product market competition and corporate governance has been discussed under the topic of X-inefficiency, the "slack in the system due to [firms] not minimizing costs or being on their production possibility frontier,"[54] which shows that a monopolist, under less competitive pressure, is likely to suffer more from agency problems (managerial slack) than a competitive firm.[55]

Competition policy then would not seem to be a complete stranger to corporate governance policy. However, while the above discussion identifies a link between the two policies, it does not provide specific guidance on how competition law could play a constructive role in corporate governance. It only suggests that competition policy should do its job of protecting competition, since healthier competition could possibly lead to better corporate governance. This is equivalent to saying that the two policies should act as cordial neighbors, simply minding their own

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50 Kenneth Heyer, *Consumer Welfare and the Legacy of Robert Bork*, 57 J.L. & ECON. S19, S20 (2014).

51 Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984).

52 U.S. courts have held that such enterprises are generally incapable of conspiring with one another for purposes of Section 1 of the Sherman Act, but there is some disagreement as to the thresholds for ownership or control that preclude antitrust scrutiny. ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 32–33 (7th ed. 2012). Similarly, in the EU, arrangements between undertakings that act as a single economic unit in the market are outside the purview of Article 101(1) of the Treaty on the Functioning of the European Union. ALISON JONES & BRENDA SUFRIN, EU COMPETITION LAW 135–37 (4th ed. 2011).

53 Farber & McDonnell, *supra* note 9, at 816–18.

54 Oliver D. Hart, *The Market Mechanism as an Incentive Scheme*, 14 BELL J. ECON. 366, 366 (1983).

55 *Id.*; Mark J. Roe, *Rents and Their Corporate Consequences*, 53 STAN. L. REV. 1463, 1472–73 (2001); Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 300 (2003); Farber & McDonnell, *supra* note 9, at 817. *Cf.* RICHARD POSNER, ANTITRUST LAW 18 (2d ed. 2001) (noting the possibility that competition may in fact reduce incentives to reduce costs, and arguing that whether or not a monopoly spurs management to innovate is an empirical question that has not yet been conclusively answered).

affairs and believing that all will be well if they do so.[56]

Another limitation to the above discussion is product market competition's differing potential in disciplining different types of agency problems. Managerial slack poses an agency problem where the manager (agent) fails to act in the best interests of the shareholders (principal). But managerial slack may be less of a concern when the corporation is effectively owned by a controlling shareholder, since the owner-controlling shareholder would be able to readily discipline an inefficient manager and have the incentives to do so.[57] In fact, when the owner-controlling shareholder also serves as the manager of the corporation, this agency problem would in theory disappear since the manager would act in his or her own best interest as the owner of the corporation.

However, such corporations are subject to another agency problem. The owner-controlling shareholder (and possibly manager) may act to the detriment of minority shareholders or other stakeholders of the corporation. And while robust product market competition can exert general pressure on the firm's managers to keep the firm efficiently managed, it is likely to be less effective in preventing the extraction of wealth from the corporation to its owner-controlling shareholders, i.e. tunneling.[58] As long as the wealth extraction does not materially impair the competitiveness of the tunneling firm and lead to its exit from the market, the owner-controlling shareholder's gains from tunneling may well exceed the loss of wealth from a decrease in the value of the tunneling firm. Product market competition therefore seems less likely to provide an effective check against such activities. The discussion on X-inefficiency is not unhelpful, but comes up rather short in properly illuminating the relationship between corporate governance and competition.

B. Re-examining the Link in the Context of Tunneling

To better grasp the relationship between corporate governance and competition policy, we will re-examine the link between the two policies in

[56] The X-inefficiency theory also fails to meaningfully inform us about the other side of the equation—the effect corporate governance rules could have on competition. To the extent that better corporate governance leads to better legal compliance with antitrust rules, corporate governance might have an indirect but positive effect on competition. Markham, *supra* note 49, at 500. But we are still at a loss as to how corporate governance rules can specifically impact market competition.

[57] Roe, *supra* note 55, at 1472. This is the case for the Korean *chaebols*.

[58] *See* Farber & McDonnell, *supra* note 9, at 820 n. 37 (noting that product market competition does not seem to be effective in resolving corporate governance issues related to self-dealing). Reputational effects or competitive pressure from the labor market for managerial talent will also be ineffective in this case, because the owner-managers are likely not interested in participating in the market for managers and it is difficult for the minority shareholders to replace such owner-managers. This is the case for the *chaebols*, who are under the ownership and management of their respective families. Ko, *supra* note 10, at 209.

the context of tunneling, which is the focus of this Article. Since the ultimate goal is to derive lessons from Korea's experience enforcing the Undue Support Clause, we choose two specific types of tunneling activity that at different times have been the subject of scrutiny under the Undue Support Clause.[59]

1. Tunneling to Prevent Failing Affiliates from Exiting the Market

(a) The Court's Condemnation of the Practice

First, consider "propping," the most extreme form of tunneling. In a propping transaction, a company transacts with (cash flow tunneling) or invests in (asset or equity tunneling) a failing affiliate with the purpose of preventing the affiliate's exit from the market. The possibility of harming minority shareholders or creditors of the company becomes starker when (i) the receiving affiliate is privately held by the owner-controlling shareholder of the firm and (ii) the conglomerate is of concentric form[60] with the two firms operating in unrelated product markets.[61]

Many of the *chaebols* experienced financial difficulties in the aftermath of the 1997 crisis and engaged in propping to save individual companies within the conglomerate from exiting the market.[62] This practice has been almost universally condemned by the courts.[63] While the possible

[59] Yong Lim, *Recounting the History of the Undue Support Clause's Enforcement: Lessons for Competition Law & Policy*, 44 BUBHAKYEONGU (JUNBOOK UNIV.) 291, 294–95 (2015) (S. Kor.). The authors note that this will lead to limitations for the analysis regarding corporate governance problems outside the context of tunneling, or even for types of tunneling other than the two examples discussed in the following. That being said, the two examples that will be discussed provides a valuable opportunity to think about the relationship between the two policies that has direct relevancy for real world enforcement.

[60] *See* J. Fred Weston, *The Nature and Significance of Conglomerate Firms*, 44 ST. JOHN'S L. REV. 66, 66–68 (1970) (categorizing different types of conglomerate firms).

[61] This would make it more difficult to justify the propping on the grounds that it would directly benefit the products or business of the supporting firm (e.g., stable supply of critical or hard-to-procure inputs). In fact, the Supreme Court has held that even if an affiliate provides key raw materials for a firm's flagship product, that alone does not justify the firm in providing economic support to alleviate the affiliate's interim cash flow problem. Supreme Court [S. Ct.], 2001Du2935, Oct. 14, 2004 (S. Kor.). Another possible reason for the propping, which is unrelated to wealth extraction, is to ensure the survival of the tunneling firm (rather than only the affiliate) by preventing the spread of credit risk within the conglomerate. This collective credit risk problem, however, has actually been used more as a reason to rigorously enforce the Undue Support Clause rather than as a justification for such propping. The Undue Support Clause is said to have been enacted to preempt the very possibility of such risks occurring by preventing excessive reliance on intragroup transactions and credit support among the member companies of a *chaebol*. KFTC, A HISTORY, *supra* note 17, at 262.

[62] This kind of propping was sometimes even extended to companies that were not member firms of the conglomerate, but were owned or controlled by extended relatives of the owner-family. *See, e.g.*, Supreme Court [S. Ct.], 2001Du7220, Mar. 12, 2004 (S. Kor.).

[63] *See, e.g.*, *id.*; Supreme Court [S. Ct.], 2001Du2304, Oct. 12, 2004 (S. Kor.). *But see* Seo, *supra*

corporate governance problems stemming from the practice are not difficult to understand, some have raised questions as to whether the court's condemnation had any basis from a competition policy perspective.[64]

The courts' explanations on why the practice would harm competition is conclusory and unilluminating. Courts have either stated that preventing the failing affiliate from exiting the market constitutes a harm to competition without providing any further explanation,[65] or they have opined that the affiliate's survival may drive existing rivals from the market and discourage new market entry.[66]

Some have attempted to explicate the court's rationale by arguing that the supported affiliate would artificially gain competitive advantages devoid of any basis on its competitive merits, which would allow the revitalized affiliate to exclude rivals from the market.[67] It has also been argued that prospective competitors would be discouraged from entering the market for fear that they would have to contend with the financial and business heft of the entire *chaebol* group, thereby reducing the contestability of the market and solidifying the market power of the *chaebol* group and its member companies.[68] Still others have argued that the cross-subsidization among the *chaebol*'s member companies would enable the supported affiliate to engage in predatory pricing or tying and thus foreclose current and prospective competitors from the market.[69] These arguments are reminiscent of past theories concerning the anticompetitive effects of conglomerate mergers, often referred to as "entrenchment."[70]

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note 40, at 38 (criticizing the court's condemnation as applying a double standard to such practices on the basis that the government itself engaged in such emergency actions during the 1997 crisis).

64 *See* Ju, *supra* note 38, at 653–54.

65 Supreme Court [S. Ct.], 2004Du3281, Apr. 29, 2005; Supreme Court [S. Ct.], 2001Du6197, Apr. 9, 2004 (S. Kor.). The courts have often described this as "maintenance of the affiliate's position in the market," while not elaborating on how specifically that would harm competition.

66 The KFTC has also condemned such practices without elaborating on why and how specifically the prevention of market exit would be anticompetitive or improper, i.e., "undue." *See*, *e.g.*, KFTC, 2001Jogi2455 (Decision No. 2001-178), Dec. 18, 2001 (S. Kor.); *see also* Lim, *supra* note 12, at 62 (criticizing the KFTC for its failure to actually assess anticompetitive effects of alleged acts of undue support).

67 Lee, *supra* note 46, at 156.

68 *Id.*

69 Lim, *supra* note 12, at 61.

70 *See*, *e.g.*, *id.* (basing such concerns on "entrenchment" effects). Some have compared the rationale underlying the KFTC and the court's position with "portfolio effects" theory. Seo, *supra* note 36, at 102–10. Portfolio effects are said to arise when a merger results in the consolidation of an array of complementary goods or services, possibly resulting in transaction cost savings for customers that purchase such complementary products from the merged firm. As is evident from the description, portfolio effects may actually benefit customers, and thus are no longer summarily condemned under conventional antitrust analysis. One may posit the possibility that the portfolio may facilitate anticompetitive conduct such as tying or predatory pricing, but condemnation now requires further require evidence that such conduct has or is highly likely to occur (post-merger). This is true even in the

(b) The Faulty Rationale Behind the Condemnation

The fundamental weakness of the entrenchment theory is its distorted view of competitive advantages provided through economies of scale and scope, essentially rendering the theory into an aversion against "bigness" itself without discerning whether the advantages are a result of efficiency.[71]

If a rival of the affiliate was eventually excluded from the market due to some competitive advantage of the affiliate like lower prices or better quality, allowing this to happen would benefit consumers, not harm them. If instead the affiliate were just able to survive in its current inefficient form with the help of the tunneling company, it seems more likely than not that it would pose little threat to its more efficient rivals, who have already been able to surpass the affiliate with or without support from a larger conglomerate group.

One could theoretically worry about predation, but that would require further proof of the existence of market entry barriers or lack of future entry following the exclusion of the rival that would render the predation unprofitable. The fact that the affiliate is already losing out to rivals and is on the verge of exiting the market would likely mean that it already has higher costs than its more efficient rivals, again making a predation strategy harder to implement.

As for the *chaebol*'s "deep pockets" reducing the contestability of the market, the fact that the affiliate is failing casts doubts on such a proposition, and if the argument is to take issue with market entry being deterred by competitive advantages conferred by size (economies of scope and scale), that is nothing more than a frontal assault on competition itself.[72] Moreover, efficient rivals who have managed to push the affiliate to the brink of market exit would presumably be able to attract investment and funding if necessary and would attempt to achieve similar economies of scale. The proffered rationale for condemning the practice of saving failing affiliates seems unsatisfactory from a competition policy perspective.[73]

EU, which has shown more willingness than the United States to prosecute based on concerns about portfolio effects. Jones & Sufrin, *supra* note 52, at 962–63. Undue supporting activities have not been limited to transactions between affiliates which produce complementary products. Funneling of business, however, could involve affiliates which provide complementary or supporting services, giving rise to tying or leveraging type anticompetitive theories. *See* Part III.B.2 *infra*.

[71] Richard Posner, *Conglomerate Mergers and Antitrust Policy: An Introduction*, 44 ST. JOHN'S L. REV. 529, 531 (1970); Cristofer Esty Lord, *Entrenchment Challenges to Conglomerate Mergers*, 60 WASH. U. L. REV. 537, 575 (1982).

[72] Lord, *supra* note 71, at 573.

[73] This is not to say that "bigness" is harmless. Bigness may result in an increased propensity to seek preferential but socially inefficient treatment from the government because a conglomerate can also benefit from economies of scale and scope in such activities as well. ADI AYAL, FAIRNESS IN ANTITRUST: PROTECTING THE STRONG FROM THE WEAK 69–70 (2014) (arguing that the conglomerate form could in theory both increase or reduce the incentives to influence governmental action); Kenneth

In fact, critics have gone so far as to argue that the practice would actually facilitate competition.[74] This argument is based on the theory that one additional competitor is better than the *status quo*. That may or may not be true. Ensuring the survival of the affiliate and allowing it to live to fight another day could result in reinvigorated competition if the affiliate were to increase its efficiency to match or exceed rivals following the injection of support. It seems hard to argue that this is likely when the affiliate is already failing. It also seems unlikely that the affiliate would be able to exert any meaningful competitive pressure on its rivals for the time because it is presumably less efficient and has higher costs than its more successful competitors.

One could also conceive of an argument that conglomerates facilitate competition in general as it makes market entry less risky and easier to the extent that the newly entering affiliate can leverage synergies created by the conglomerate form.[75] While this again is theoretically possible, it would not seem applicable to the current case where the *chaebol* has already entered the market and the prospects of the affiliate reinvigorating competition in the foreseeable future seems low at best.[76]

(c) The Possible Harm to Competition from the Practice

So does this mean that the practice is net neutral in its effect on competition? In fact, there may be just enough of a concern to tip the scales towards condemning the practice, at least under certain circumstances. When one takes a dynamic view of competition, the practice might have lingering pernicious effects. It is not so much the survival of the inefficient affiliate itself that is the problem, but the perception it creates that the *chaebol* will do whatever is necessary (i.e., engage in acts that are unprofitable regardless of the possibility of recoupment) to sustain the failing affiliate.

Note that this is different from the "entrenchment" or "deep pocket" theory. There, the objection was against the competitive advantage

Elzinga, *The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?*, 125 U. PA. L. REV. 1191, 1197–98 (1977). While antitrust could conceivably play a role in alleviating the problems of "political influence," AYAL, at 71–72, that issue exceeds the scope of this Article.

74 Ju, *supra* note 38, at 653–54.

75 Elzinga, *supra* note 73, at 1197; Weston, *supra* note 60, at 73.

76 The KFTC has also cited reduced incentives to compete (slack) on part of the supported affiliate as a possible concern of undue support. KFTC, A HISTORY, *supra* note 17, at 262. This seems unlikely to harm consumers in our case since any additional inefficiency on the part of the affiliate will only hasten its demise or increase the costs of keeping it alive. Since the affiliate is already being priced out of the market by its more efficient rivals, it would not be able to increase prices towards consumers. One might argue that the increased slack would further lessen the competitive pressure from the affiliate on its rivals, but the decrease in pricing pressure may well be insignificant considering that the affiliate is already on the verge of exiting the market.

conferred by efficiencies resulting from the size and scale of the *chaebol*. A more or equally efficient rival could still outcompete the affiliate, and even procure funds from the financial markets if necessary to match scale and improve its competitiveness. The running assumption was that the affiliate might attempt to leverage the synergies it can realize as a member of the conglomerate group, not that the affiliate or the *chaebol* as a whole would engage in unprofitable activities. In our case, however, the above perception, which would be further reinforced by the practice, could chill the rival's incentives to invest in efficient cost-reducing activities because any resulting price reduction would be readily matched by the affiliate via the support, and thereby deprive the rival of the opportunity to fully realize the efficiency gains from the activities. In the long run, this harms consumers as well because it results in higher prices or, put differently, reduces the rival's incentives to lower prices.[77]

This is also distinguishable from the predation theory previously discussed, since the concern here is not that rivals will be priced out, but that they will be less incentivized to engage in price competition themselves.[78] Also, the predation theory presumes that the affiliate (or *chaebol* group as a whole) will be able recoup its losses following the exit of its rivals, not simply absorb them (indefinitely) as in our case.

This chilling effect is less likely to be a concern if the market in which the affiliate participates is competitive, while being more of a concern in oligopolistic markets or those dominated by *chaebol* affiliates all backed with a guarantee of support. Thus, ideally, condemnation of the practice would only come after an analysis of the market structure and proof of actual or potential anticompetitive effects. However, such an analysis could be time consuming, costly, and prone to error since the dampening of price competition may not be readily visible. In this regard, one could conceivably understand the court's position as taking the view that such chilling effects are more likely than not to occur and will be more pernicious in markets where the *chaebol*s are active based on the significant economic concentration and structural issues of the nation's economy previously discussed. The merits of such a view can be debated, but this provides an explanation for the courts summarily condemning the practice without a proper analysis into its effects on competition.

[77] Note that incentives for destructive innovation may still be preserved despite such chilling effects, which would likely impact incremental innovation incentives.

[78] Nor is the theory based on a fear of retaliation (including predation) from the affiliate or its other *chaebol* members.

2. Tunneling by Funneling Business to an Affiliate

(a) Funneling of Business as a Form of Tunneling

Funneling of business (*il-gam-mo-rah-joo-gi*) is a phenomenon that has recently been the subject of much controversy in Korea.[79] It describes a situation where one or more of the member companies in a *chaebol* group decide to direct all or a substantial portion of one or more of their business requirements to an affiliate in the group. Efficiencies may drive such decisions. For example, it may be nothing more than an attempt to achieve economies of scale in the procurement of services or distribution of goods, and thereby reduce related costs, which is entirely procompetitive.

This usually benign practice has come under fire in situations where a business opportunity of significant scale and volume is diverted away from competitive third parties in the market to an affiliate privately held by the *chaebol*'s owner family. The price charged by the affiliate is substantially higher than the price that would have been obtained in the market through competitive bidding. Instead of the *chaebol* companies sharing in any efficiency gains possibly achieved by pooling one or more of the *chaebol* companies' business, all or most of the efficiency gains are appropriated away by the owner family. The privately held affiliate essentially acts as a vehicle for extraction.[80]

It is possible to provide a justification for diverting the opportunity away from the market into the hands of an affiliate. The affiliate's competitors may have been unwilling to undertake relationship specific investments required by the *chaebol* companies, and thus the practice could have been necessary to resolve a hold-up problem.[81] The costs of investment required by the affiliate could also explain an initial increase in price compared to the *status quo*.

This, however, does not explain why it would be more beneficial to the funneling company and its shareholders to direct the company's business to a privately held affiliate controlled by the owner family, rather than establish or transact with a subsidiary, which would enable the company to better share in the efficiency gains.[82] There is yet again a possible

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[79] Lim, *supra* note 59, at 308–11.

[80] The main criticism against the practice is that it serves as a tool for a generational transfer of wealth within the *chaebol*'s owner family. Critics have pointed to figures that show a higher rate of funneling of business in cases where the son or daughter of the current Chairman holds a higher portion of equity in the affiliate to which the business is funneled. *Id.* at Part IV.2.(1).

[81] LUIS CABRAL, INTRODUCTION TO INDUSTRIAL ORGANIZATION 41 (2000).

[82] Other justifications have been suggested for the practice, which have been reflected in the MRFTA Enforcement Decree. Dokjeom-Gyuje Mit Gongjeong-Georae-e Gwanhan Beobryul Shihaengryung [Enforcement Decree of the Monopoly Regulation and Fair Trade Act], Presidential Decree No. 25173, Feb. 11, 2014, apps. 1-3, 1-4 (S. Kor.). These include the need to maintain

justification. If there are significant risks involved in carrying out the business, outsourcing it to a third party may be part of a risk mitigating or sharing measure. Only here, since non-affiliated third parties are not willing to undertake the costly requisite investments, the owner family has decided to do so and has benefitted the other non-controlling shareholders in the process. This explanation, however, is belied by the fact that the diverted business rarely seems to fit this description. Instead, the business directed to the privately held affiliate has often been stable and lucrative, backed by an implicit guarantee of flow of business from other member companies in the *chaebol* group.[83]

Again, the possible agency problem between the owner family (controlling shareholders) and the other shareholders seems fairly apparent. The question is whether the practice also gives rise to cognizable harm to competition.

(b) Proffered rationales for the practice's harm to competition

At first glance, there does not seem to be anything inherently anticompetitive about the practice itself. Indeed, even if the practice's sole purpose were to serve as an extraction scheme, there seems to be no apparent reason to believe that the transfer of wealth from one company to another (or from one shareholder to another) would automatically result in harm to competition.[84]

There have, however, been attempts to explain why competition would be harmed as a result of funneling. The concerns raised against the practice come in two broad categories. The first concern is that the affiliate has been able to leverage its position as a member company of the *chaebol* group to gain competitive advantages. The focus of both the KFTC and the courts on the preferential terms enjoyed by the affiliate, like higher transaction prices or greater volume, are a reflection of this argument.[85] This seems more of

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confidentiality or ensure stability for critical services, *etc.* These would all seem like justifications for diverting the business away from the market rather than one for directing the business to a privately held affiliate.

[83] *See, e.g.*, KFTC, 2007Josa0485 (Decision No. 2007-504), Oct. 24, 2007 (*Hyundai Glovis* case) (S. Kor.). For a more detailed description of the case, *see* Lim, *supra* note 59, at IV.1.

[84] Young-Hoa Son, *Gyeyeolsa Budang Jeewon Hangwee Gyuje-eui Beob-juk Jaengjum-kwa Gaesun Bangan – Ilgammorajoogee, Budang Naeboo Georae-leul Joongshim-euro* [*Legal Issues and Improvements for Regulation of Undue Support Among Affiliates: Focusing on Funneling and Undue Intra-Transactions*], 12 ECON. L. 25, 47–48 (2013) (S. Kor.).

[85] KFTC, 2012Sugam2312 (Decision No. 2012-040), Mar. 21, 2012 (S. Kor.); KFTC, 2012Shigam0470 (Decision No. 2012-227), Sept. 3, 2012 (S. Kor.); Supreme Court [S. Ct.], 2004Du7610, Jan. 25, 2007 (S. Kor.); Seoul High Court [Seoul High Ct.], 2007Nu30903, Aug. 19, 2009 (S. Kor.); *see also* Eun-Jung Ahn, *Gongjeong-Georae Beobsang Budang Jeewon Hangwee Gyuje — Ilgammorajoogee-leul Joongshim-euro* [*Regulation of Undue Support under the MRFTA: Focusing on Funneling of Business*], 11 ECON. L. 211, 220 n. 30 (2013) (S. Kor.) (listing other recent enforcement

an objection to bigness rather than a valid concern about harm to competition. While attaining better terms than rivals and bringing in higher revenue through large volumes of affiliated transactions may seem patently unfair to some, this does not automatically lead to higher prices or a reduction in quantity in the market where the affiliate is active. We have already reviewed the shortcomings of the entrenchment or deep pocket theory, so there is no need to repeat what has already been discussed.

The second category of concern seems better grounded in that it focuses on the competitive effects of the practice. The concern here is that rivals in markets of either the funneling company or receiving affiliate may be foreclosed from their respective markets.[86] Funneling naturally closes a portion of the market (e.g., volume corresponding to the funneled business) from rivals, who are now faced with truncated markets that do not include the funneling companies in the upstream market (e.g., manufacturing) and the receiving affiliate in the downstream market (e.g., transportation).[87] The anticompetitive theory is similar to one involving tying or exclusive dealing, which may reflect the fact that the funneling company will divert virtually all or most of its relevant business to the affiliate. This means that the funneling company will often be exclusively dealing with the affiliate, or in effect tying their respective products with the affiliate's product or service.[88] The theory is summarized in the following.

The affiliate is able to impair the efficiency of its rivals because the exclusively funneled business represents a significant enough portion of the market to prevent rivals from achieving minimum efficient scale. This will dampen the incentives of the affiliate's rivals to engage in price competition, because any gains from lowering prices will now be smaller due to the rivals' inability to wrestle away the business of the funneling firm(s). The affiliate's rivals, deprived of their minimum efficient scale, may in fact be forced to raise their prices to the funneling company's rivals.[89] And if the affiliate's rivals are excluded from the market, the funneling company's rivals are now deprived of efficient alternatives to the affiliate (to the extent that the downstream product is complementary to the upstream product), and can be excluded from the upstream market themselves.[90]

actions by the KFTC).

86 Son, *supra* note 84, at 29; Ahn, *supra* note 85, at 213.

87 The opposite case is also possible where the funneling company is in the downstream market and the receiving affiliate in the upstream market supplies services or input to the funneling company.

88 Such exclusivity may not necessarily be memorialized in a legal binding document between the parties, as they are under common control of the owner family of the *chaebol* group.

89 The opposite may also happen where price competition heats up among the rivals in an attempt to gain the remaining business.

90 Note that the anticompetitive theory presumes that the funneling company or companies collectively will have a monopoly or enjoy significant market power in the upstream market. If not, the

This type of concern, however, is subject to the same challenge that so-called leverage theories have faced in the past. The challenge comes from the single monopoly profit theorem. Its rather simple but powerful intuition is that a monopolist in the upstream market cannot profitably leverage its market power into the downstream market for a complementary good. Because consumers consider the total price paid for both the upstream good and downstream good in making consumption decisions, an increase in price in the downstream market will concomitantly decrease the price in the upstream market. Hence, even if the monopolist were to monopolize the downstream market, it cannot increase its total profits in excess of the monopoly profits it is already reaping in the upstream market.[91] If the single monopoly profit theorem holds, the monopolist lacks the incentive to leverage its market power into the downstream market.[92] In fact, to the extent that exclusionary conduct is costly, a leveraging strategy might result in reduced overall profits, since such costs would have to be deducted from the total monopoly profits. This means that even if funneling were to occur, it would be the result of efficient behavior rather than an anticompetitive strategy.

The single monopoly profit theorem, however, is not without limitations. One well-known exception is when the upstream market is contestable and not fixed as the theorem assumes. If a downstream rival of the affiliate could enter into the upstream market and threaten the upstream funneling company's monopoly, the funneling monopolist may have an incentive to monopolize the downstream market and eliminate the threat.[93] The funneling monopolist may also attempt to raise entry barriers by monopolizing or excluding competitors of the affiliate in the downstream market because this would increase entry costs by requiring a two-market entry on the part of potential upstream rivals.[94] The single monopoly profits theorem also assumes that the downstream product does not have consumption value independent of the upstream product. To the extent that the receiving affiliate has upstream customers other than the funneling monopolist, this means that the affiliate's product or service has independent consumption value. Thus, the funneling monopolist can assist the affiliate in increasing its overall profits without sacrificing the

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theory fails because the affiliate's rivals will be able to continue to compete without their efficiency being impaired despite the funneling.

91 ROBERT A. BORK, ANTITRUST PARADOX: A LAW AT WAR WITH ITSELF 372–75, 380–81 (1978); EINER ELHAUGE, U.S. ANTITRUST LAW AND ECONOMICS 359 (2d ed. 2011).

92 Rather, one would imagine that the upstream monopolist would prefer a competitive downstream market since that would diminish the price of the downstream product to marginal cost and enable the monopolist to maximize its rent in the upstream market.

93 Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397, 417 (2009). The threat in this case would be entry into the upstream market.

94 *Id.* at 417–18.

monopolist's own profits, by excluding downstream competitors of the affiliate from the market and enabling the affiliate to increase the price to customers other than the funneling monopolist.[95]

(c) An Interesting Twist to the Single Monopoly Profit Theorem in the Case of Funneling

The last scenario mentioned above regarding the single monopoly profit theorem hints to an interesting twist in the case of funneling. Might an upstream monopolist still choose to leverage its market power to monopolize the downstream market even when such leveraging would result in sacrificing its own profits, i.e., even in cases where the single monopoly theorem holds?

The single monopoly profit theorem is predicated on the basic assumption that the monopolist will conduct its business in a profit maximizing manner. But in cases of funneling, the owner family (controlling shareholders) behaves in a manner which maximizes their own wealth rather than just the company's profits, which is the sum of the wealth derived from both the funneling company and the receiving affiliate. This means that the owner family may direct the company to engage in funneling that does not maximize the profits of the funneling company if it results in an increase in the owner family's total combined wealth from the two companies. A simple example may be illustrative.

A manufactures product α, and B manufactures product β. A has a monopoly over α, and the product market for β is competitive. We assume that α costs 10 to produce and is sold at 15, and β costs 5 to produce and is sold at cost. For simplicity, we assume constant costs and homogenous products. We further assume that β is a complementary downstream product of α, is consumed in a fixed proportion with α (1:1), and is not separately consumed from α. Thus, the single monopoly profit theorem holds.

Since customers consume 1 unit of α together with 1 unit of β, assuming that A is maximizing its profits by charging a monopoly price for α, A's current profit is 5 {(15 + 5) – (10 + 5)}. If A were to enter the product β market, leverage its market power in the upstream market, and succeed in monopolizing the downstream market (e.g., through a tie of both of its products), the total combined profit it could make in the two markets would still be 5. This is because any increase in the now monopolized price of β would entail a concomitant drop in α's price to lure customers who now face a higher price for β.

The results would be the same even if firms A and B were wholly owned by shareholder X. A exclusively supplies α to B (funneling) in an

[95] *Id.* at 416. If, as in usual cases of tying, the downstream product were also produced by the monopolist, it would increase its overall profits as a result of this strategy.

attempt to exclude B's rivals. Even if A were to succeed in assisting B to monopolize the downstream market, X could not increase the profits derived from A or the combined profits derived from both companies. Thus, X does not have an incentive to direct A to assist B in monopolizing the downstream market by funneling business to B.

Let us now assume that X holds 50% of A's equity and 100% of B's equity. The wealth X derives from both companies through the sales of α and β is 2.5 {(5 x 50%) + (0 x 100%)}. As in the above case, A assists B in monopolizing the downstream market by funneling its business. After monopolizing the downstream market, B now increases its price by 5 to 10, while A decreases its price by 5 to also 10. While the combined profits of A and B remains 5 {(10 – 10) + (10 – 5)}, X's wealth increases twofold to 5 {(0 x 50%) + (5 x 100%)}. Thus, X has an incentive to direct A to funnel business to B and thereby exclude B's rivals as long as its equity ownership in B is higher than in A.[96] This is true even in cases where the single monopoly profit theorem holds and the combined profits of both companies cannot be increased. In other words, X will direct A to engage in anticompetitive conduct (exclusion) since it allows X to extract more wealth (monopoly profits) from B.

Some may point out that the total price consumers face has not increased and remains at 20, and therefore argue that consumer welfare will not be harmed. That may or may not be the case depending on the long run balance of the benefits and costs of a monopoly in the product β market. The point here is that when the owner family's (controlling shareholder's) degree of control (i.e., ability to extract wealth from the company) differs between companies they control; the owner family may have the incentive to engage in funneling that is anticompetitive even when the single monopoly profit theorem holds. The incentive to engage in such anticompetitive funneling generally increases the lower the owner family's equity in the funneling company or the higher the owner-controlling shareholder's equity in the receiving affiliate.[97]

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[96] *See also* Seo, *supra* note 36, at 169 (arguing that the controlling shareholder's incentive to engage in tunneling increases as the mismatch between the controlling shareholder's share of equity in the tunneling company (A in the above example) and his or her control over the company grows (i.e., the controlling shareholder's equity share decreases)).

[97] One might question whether X would be capable of actually implementing the above funneling scheme over the objections of the non-controlling shareholders of A. According to the example above, corporate profits are shifted from A to B to the detriment of A's non-controlling shareholders. As such, one would expect the shareholders to object to any attempt by X (or A's controllers) to implement such a funneling scheme. Information regarding tunneling activities may not become readily available or recognizable to shareholders even under current disclosure rules, and in certain cases could be implemented over the objections of minority shareholders.

3. The Copperweld Objection

The discussion so far shows that tunneling, which raises problems for corporate governance policy, can—under certain circumstances—harm competition as well. However, there remains an objection to be addressed, which argues against competition law's interjection into corporate governance issues. We will call it the *Copperweld* objection, because its arguments follow the decision of that case.

As briefly discussed above, *Copperweld* and the court decisions that followed essentially state that companies under common control (e.g., a parent and its wholly owned subsidiary) cannot conspire with one another for purposes of Section 1 of the Sherman Act.[98] The underpinning logic of the court's decision that the *Copperweld* objection musters is that such affiliated transactions should be treated like intra-firm dealings between different business units within a single corporation. This is because the companies ultimately act under the direction of a single economic and business mind and thus comprise a single business entity for purposes of antitrust law. Since antitrust does not take issue with intra-firm dealings, it should not be concerned with dealings between affiliates under common control that are no different in reality.[99]

Korean competition law also provides for a similar exception in the case of cartels under the "de facto single business entity" theory.[100] The Undue Support Clause, however, specifically targets affiliated transactions and thus contradicts *Copperweld* where tunneling is involved. Indeed, the Korean Supreme Court has ruled that the clause even applies to transactions between a parent and a wholly owned subsidiary.[101]

In sum, according to the *Copperweld* objection, the Undue Support Clause is a legislative error because affiliated transactions are not the concern of competition law or policy. Because the *Copperweld* objection is predicated on the argument that transactions between companies under common control are no different from intra-firm dealings between different business units, it is important to understand why intra-firm dealings are not subject to the scrutiny of Section 1 of the Sherman Act. *Copperweld* is not a repudiation of the fact that intra-firm or affiliated dealings can and do result in harm to competition. Indeed, the U.S. Supreme Court recognized that the

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98 *See supra* notes 44–45.

99 Ok-Rial Song, *Gieob Jibdan Budang Naeboo Georae Gyuje-eui Beobjeongchaek-jeok Ihae* [*Regulation of Intra-Group Transactions: An Economic Analysis*], 46 SEOUL L.J. 227, 235 (2005) (S. Kor.). *See also* Ju, *supra* note 38, at 657 (criticizing the courts' condemnation of transactions between a parent and its wholly owned subsidiary for undue support as nonsensical).

100 KFTC, GUIDELINES FOR CONCERTED PRACTICE REVIEW 2 (2009), http://eng.ftc.go.kr/files/static/Legal_Authority/Guidelines%20for%20concerted%20practice%20Review_mar%2014%202012.pdf (S. Kor.).

101 Supreme Court [S. Ct.], 04Du1483, Dec. 22, 2006 (S. Kor.)

judgment would create a "gap" between Section 1 and Section 2, whereby anticompetitive conduct might not be reachable under the Sherman Act.[102] Rather, the point was that it is impractical to expect intra-firm business units to act with independent and separate interests from one another for antitrust policy purposes.[103] Business units within a corporation all act with a unity of purpose. They do not and should not be expected to compete with one another or diverge in their incentives for maximizing the total profit of the corporation.[104] Accordingly, even if the business units were to agree to restrain competition, such an agreement, in and of itself, would not result in a cognizable loss of competition that would have otherwise existed from an antitrust perspective. If, however, the intra-firm dealings are part of a monopolization scheme, it can be prosecuted under Section 2 of the Sherman Act. For example, illegal tying can occur whether the tied products are manufactured by a single company, a company and its affiliate, or a company and a third party. The *Copperweld* objection misconstrues the judgment's logic when arguing that affiliated transactions have nothing to do with competition law and policy. In the prior analysis of the two types of tunneling activities, the possible anticompetitive effects are not predicated on some loss of competition or divergence of interests that would have existed had the transaction not taken place. The fact that the tunneling activity could well be characterized as monopolization under Section 2 of the Sherman Act also evidences this point.

The *Copperweld* objection could instead be construed as an argument that competition is likely to be harmed only if and when the tunneling company or receiving affiliate acts upon the increase in market power resulting from the tunneling.[105] Thus, competition policy should concern itself with the subsequent anticompetitive conduct rather than waste resources in going after the tunneling practice itself. This point is worth considering, because one can imagine cases where the tunneling would likely not have a substantial impact on competition, e.g., where the amount of wealth extracted was insignificant. This, however, is more of an argument on enforcement priorities rather than an argument that tunneling has nothing to do with competition. Also, in the case of the tunneling activities analyzed above, the chilling effects on price competition are triggered by the behavior itself rather than some separate and subsequent

[102] 467 U.S. 752, 774–76 (1984).

[103] ELHAUGE, *supra* note 91, at 513.

[104] Another reason for excluding inter-firm dealings from antitrust scrutiny is that the administrative costs of discerning whether an agreement exists and whether it is anticompetitive would be significantly higher than cases that involve dealings with entities outside of the firm. For example, such inter-firm dealings may lack the documentation and evidence usually found in the case of external dealings. This reason, however, seems less relevant in our case because tunneling usually involves transactions with a separate entity outside of the company even if it is with an affiliate.

[105] Song, *supra* note 99, at 237.

conduct. The anticompetitive monopolization of the affiliate's relevant market via funneling is also the result of the funneling activity itself, and not the result of some separate conduct. The point here is not that tunneling always impairs competition, but that it can do so.

A cautionary note is warranted. In the case of funneling, an anticompetitive theory that the funneling firm attempted to monopolize the affiliate's market based on a wealth extraction strategy for the owner family would fail if the affiliate was a wholly owned subsidiary of the funneling company as shown through the previous analysis. But this is not so because of *Copperweld*'s logic or the funneling company's control over the affiliate, but because the wealth extraction theory would not work (i.e., the funneling is unlikely to result in an increase of the owner family's wealth), implying that there must have been some other, and possibly efficient, motivation for the activity.

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We have now confirmed that tunneling can have adverse consequences for both corporate governance and competition, and that both policies may have legitimate concerns over such activities. It then seems hasty to conclude that competition policy and corporate governance have nothing to do with one another and should simply go on their separate ways. In the following, we further look at the implications from Korea's experience with the Undue Support Clause for regulating tunneling.

IV. LEARNING FROM THE UNDUE SUPPORT CLAUSE: IMPLICATIONS FOR REGULATION OF TUNNELING

Related party transactions, such as tunneling, bring to the forefront the issue of conflicts of interest, which is a core concern of corporate governance policy. In most countries, the existing law focuses on permitting beneficial related party transactions while prohibiting harmful ones (e.g., tunneling) rather than imposing an absolute ban on all related party transactions. In the U.S., for instance, securities regulations and corporate law are the primary regulators of related party transactions; the former primarily harnesses disclosure requirements, and the latter largely provides for ex-post remedies for conflict of interest transactions.[106] Both aim for an effective distinction between beneficial related party transactions and tunneling in order to protect shareholders' interests. As discussed above, however, tunneling activities that involve companies with market power can also harm competition and raise concerns under competition law and policy. Table 1 below formalizes the four possible scenarios regarding related party transactions.

[106] *See generally* Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUM. BUS. L. REV. 663 (2014).

TABLE 1: RELATED PARTY TRANSACTION SCENARIOS

	Benefits Competition (or at least does not harm it)	Harms Competition
Benefits Shareholders	—	Triggers Competition Law
Harms Shareholders	Triggers Corporate Governance Law	Triggers Corporate Governance Law *and* Competition Law

When a transaction is beneficial to shareholders and does not harm competition, neither corporate governance nor competition laws will forbid the transaction. When a transaction harms shareholders, but not competition, it comes under the scrutiny of corporate law. By contrast, when a transaction harms competition while benefitting shareholders at the same time, the transaction would be subject to scrutiny under competition law. The focus of our Article is on the last scenario where a related party transaction harms both shareholders and competition. In theory, both competition law and corporate governance laws could be invoked, but the legal response to tunneling has been different across countries. While U.S. antitrust law stands ready to prosecute competitive harms caused by tunneling, for various reasons it takes a relatively backseat role compared to corporate governance laws which focus on the adverse impact of tunneling on (minority or non-controlling) shareholders. On the other hand, as mentioned above, in Korea competition law has often provided the primary regulatory response to tunneling. This contrast to the approach in the United States and elsewhere provides a valuable opportunity to take a closer look at how competition law can play a meaningful role in regulating tunneling and its implications for both antitrust and corporate governance policy.[107]

A. Implications for Antitrust Law

As noted earlier, the intraenterprise conspiracy doctrine espoused under *Copperweld* impedes the prosecution of tunneling activities under Section 1 of the Sherman Act in U.S. antitrust law. While tunneling

[107] There are of course major distinctions between the two countries with respect to prevalent corporate ownership structures and the corporate laws that govern them. In Korea, the small coterie of *chaebols* exert significant influence in the market and the general economy. On the other hand, the U.S. economy has evolved through a high dependency on equity financing and dispersed ownership structures, leading to a more shareholder-centric focus for its corporate laws. This has led to an emphasis on the protection of retail investors, with shareholder wealth maximization being generally accepted as the primary goal of corporate governance law. The difference, however, significantly decreases when it comes to publicly traded companies with controlling shareholders.

activities in the form of unilateral action by monopolies can be punished under Section 2 of the Act, this would not be the case for tunneling activities undertaken at companies that do not qualify as monopolists but nevertheless wield significant market power. In applying the *Copperweld* analysis to specific cases, U.S. courts have traditionally focused on whether the parties are under common control by primarily relying on equity ratios.[108] In Part III.B.2 we saw, however, that even in cases where parties of the transaction are under common control, differences in equity holding ratios may provide incentives for anticompetitive agreements between the parties. Accordingly, this warrants a careful reconsideration of the singular focus on the existence of control under the intraenterprise conspiracy doctrine, and raises the question of whether the degree of control (as reflected in the equity ratios) should also be a factor in deciding whether to extend *Copperweld* to particular cases, at least where there are allegations of anticompetitive tunneling.

Our analysis of the anticompetitive potential of tunneling activities also highlights the role of *intent* in assessing whether a particular conduct is exclusionary under Section 2 of the Sherman Act. Courts nowadays tend to agree that a general willingness to decimate one's competition is insufficient to find a particular conduct exclusionary.[109] Intent, however, can be useful in understanding the likely effects of the disputed conduct, [110] particularly if the conduct has the potential to be both anticompetitive and procompetitive. Funneling, for example, will often take the form of exclusive or near-exclusive dealing between the related parties, and such dealings are not anticompetitive by nature. The point is that when the intent behind the particular transaction between the related parties is to extract private benefits for the controllers of the firm (i.e., tunneling), this should raise a red flag for a closer look at the possible, and in some cases likely, anticompetitive effects of the conduct.

B. Implications for Corporate Governance Law

We now turn to the potential implications of Korea's unique regulation of tunneling activities for corporate law. Traditionally under the U.S. state corporate laws, the main remedy for tunneling is a shareholder derivative action based on the breach of a controller's fiduciary duty of loyalty. In addition to the directors' fiduciary duty to shareholders, U.S. corporate law has long recognized the controlling shareholder's fiduciary duty to the

[108] ANTITRUST LAW DEVELOPMENTS, *supra* note 52, at 33.
[109] *Id*. at 244.
[110] United States v. Microsoft Corp., 253 F. 3d 34, 59 (D.C. Cir. 2001) (stating that intent would be "relevant only to the extent it helps us understand the likely effect of the monopolist's conduct.").

company and to minority shareholders.[111] In a derivative suit by minority shareholders, the critical issue is whether the conflict of interest transaction can be deemed "fair." When a controlling shareholder stands on both sides of a transaction, courts generally apply the most stringent standard of review, and the controlling shareholder as an interested party (i.e., defendant) bears the burden of proof of showing that the transaction was fair.[112] Fairness, in this context, consists of two elements: whether the transaction at issue went through a fair decision-making process (fair dealing) and whether the price paid (or the terms of the transaction) was fair (fair price).[113]

Although the courts in Delaware have emphasized that these two prongs of the entire fairness standard—fair dealing as procedural fairness and fair price as substantive fairness—are separate concepts, the courts have also emphasized that "the test for fairness is not a bifurcated one as between fair dealing and fair price" and that "all aspects of the issue must be examined as a whole" to determine the entire fairness of conflict of interest transactions, of which tunneling would be a prime example.[114] While verifying the "fair dealing" prong, i.e., whether a transaction satisfies the procedural requirements, has been fairly straightforward, evaluating the fair price of the challenged transaction has been more difficult, partly due to the lack of a uniform standard for determining whether the transaction's price was fair. This has led to an emphasis on fair dealing when applying the entire fairness test; when a transaction at issue satisfies screening procedures by disinterested and independent directors or minority shareholders, courts have shown a tendency to uphold the transaction based on the underlying assumption that fair dealing generally leads to a fair

[111] Kahn v. Lynch Commc'n Sys., Inc., 638 A 2d 1110, 1113–14 (Del. 1994); Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109–10 (Del. 1952).

[112] The Delaware supreme court has held in the context of parent-subsidiary mergers:

> [w]hen directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.

Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (citations omitted).

[113] The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock . . . . Here, we address the two basic aspects of fairness separately because we find reversible error as to both.

Id. at 11.

[114] *Id.*

price.[115] As a consequence, controllers have focused on setting up the necessary procedural protections, including approval by independent directors or minority shareholders, when executing a conflict of interest transaction.

However, the court's treatment of tunneling by controlling shareholders has begun to evolve. In the *Southern Peru Copper* case,[116] the Delaware Chancery Court looked beyond the nominal independence of a special committee in evaluating procedural fairness and inquired into whether the special committee was "well functioning," free from the influence or pressure of the controlling shareholder.[117] For this purpose, the Chancellor considered "the substantive decisions of the special committee, a fact intensive exercise that overlaps with the examination of fairness itself."[118] That the Chancellor was willing to further look into the substance of the transaction suggests that, going forward, the examination of whether the transaction's "price" was fair may become more important in applying the entire fairness test.

In this regard, Korea's unique application of competition law to tunneling transactions raises an interesting possibility of considering the competitive state of the relevant markets in answering whether a conflict of interest transaction satisfies the entire fairness test. Let us suppose a situation where two companies, each facing a competitive market environment, transact. In this case, regardless of whether the companies are under common control, the fact that they face strong competition in their own respective markets can indicate that the transaction between them would have been executed on "competitive" or "fair" terms. If not, the company that receives the bad end of the deal would suffer, and its prospects of survival in the competitive market environment would diminish in the long run.[119] For a court confronted with the task of determining whether a conflict of interest transaction has been executed on fair terms, the fact that both companies face sufficient competitive pressure

[115] *See* Americas Mining Corp. v. Theriault, 51A.3d 1213, 1244 (Del. 2012); Auriga Capital Corp. v. Gatz Props., LLC, 40 A.3d 839, 857 (Del. Ch. 2012) (noting that the court properly considered how interested party dealt with minority shareholders (fair dealing) in determining the fair price because "the extent to which the process leading to the self-dealing either replicated or deviated from the behavior one would expect in an arms-length deal bears importantly on the price determination.").

[116] *In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 789 (Del. Ch. 2011), *aff'd sub nom.* Americas Mining Corp. V. Theriault, 51 A. 3d 1213 (Del. 2012).

[117] *Id.* at 789.

[118] The court recognized the possibility of a controller pressuring the approving entity (independent directors or disinterested shareholders), and substantively analyzed the situation in determining whether there had been "fair dealing." *Id.* at 788 n.79 ("Facing the proverbial 800 pound gorilla who wants the rest of the bananas all for himself, chimpanzees like independent and disinterested stockholders could not be expected to make sure that the gorilla paid a fair price.")

[119] This would also make the controllers worse-off, making it less likely that they would engage in such activities.

in their respective markets could serve as indirect proof that the challenged transaction satisfies the entire fairness test.

Conversely, when at least one of the companies enjoys significant market power in its market, the common controller(s) could, under certain circumstances, privately benefit by leveraging that company's market power to enhance the other company's competitive position, resulting in a higher likelihood of non-competitive or unfair terms. For example, if company X is shown to have attempted to monopolize the market in which Y operates by leveraging its market power, and if X and Y are under common control by a common controller but under differing degrees of control, such circumstances could imply that there was a deliberate shift of possible gains or profits from X to Y to the detriment of the minority shareholders of X. These two aspects—market power and disparate degrees of control (ownership)—could be useful for the plaintiff-shareholders to show that the defendant-controller has sufficient incentive and has engaged in tunneling.[120]

One might still question why corporate law should consider the competitive impact of tunneling on consumers. If a particular conduct harms competition and can be scrutinized under antitrust law, this raises the question whether additional intervention by corporate governance law might be unnecessary or redundant. Private antitrust litigation can only be raised by those that suffer antitrust injury and thus has limitations in terms of standing.[121] Antitrust enforcement by agencies is also constrained by limitations in resources, and is unlikely to cover the broad swath of tunneling activities undertaken throughout the corporate community. A corporation's shareholders are likely those that have the strongest incentive in investing the time and resources to monitor tunneling activities. While shareholders may also suffer from short-termism, thus hobbling their incentives to discern and target tunneling activities that harm long-term

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[120] Even in the absence of any unfairness in the short-term, when one of the parties to a conflict-of-interest transaction wields significant market power, such transactions can lead to a long-term destruction of shareholder value. Suppose X, a retail company, enters into an exclusive sourcing contract with Y for product A. Y is an affiliate of X under common control. X is a monopolist or wields significant market power in the relevant retail market. Even when the sourcing contract contains fair (market-value based) terms, if the exclusive contract results in the diminishing of competition in the market for product A in the long-run or eventually forecloses Y's rivals, once the competition has been eliminated or substantially reduced, Y will have a much lower incentive to innovate and supply X with a better quality product at a lower price in the long-term. In other words, in the short term, the exclusive contract might be neutral or even beneficial for X's shareholders, but in the long run it may harm X's shareholders by forgoing additional efficiencies that would have resulted from robust competition in the market for product A. It would probably be too speculative for a court to consider such long-term consequences at the time X's shareholders challenged the fairness of the exclusive sourcing contract. The example, however, shows how anticompetitive conduct could harm not only consumers but shareholders as well.

[121] Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 334 (1990).

shareholder value, this should not provide reason for limiting corporate governance's focus to only short-term shareholder value considerations. Thus, it seems more desirable than not to incorporate the competitive impact of the related party transaction when undertaking a fairness analysis.[122]

V. CONCLUSION

The Undue Support Clause is a unique feature of Korean law in that it utilizes competition law as a tool to regulate conduct that has traditionally been the concern of corporate governance law and policy. Criticism that a corporate governance problem has nothing to do with competition or *vice versa* does not seem well founded when examined in the context of tunneling conduct targeted by the Undue Support Clause. At the same time, there has been some confusion about when and how tunneling can cause harm to competition, and much of the rationales proffered in the past seems to have their roots in an antiquated and discounted theory of harm caused by the conglomerate form. This Article has attempted to clear away some of the confusing and erroneous rhetoric that has cluttered the path to exploring the role competition law can play in corporate governance policy. This is certainly not a complete survey of all the intricacies and issues that can arise when competition and corporate governance intersect with one another. Nevertheless, the history of the Undue Support Clause's enforcement provides an invaluable opportunity to explore the topic because it provides a rare real world example.

As Korea's competition law continues its journey into the realm of corporate governance, there will be more opportunities to reevaluate the relationship between competition and corporate governance. For now, the Undue Support Clause has managed to prove that competition law is not irrelevant to corporate governance and can indeed play a role in soothing some of its chronic ailments.

[122] We do not argue that an analysis of market competitiveness or possible anticompetitive harm should always be taken into account in breach of duty of loyalty litigation under corporate law. Rather, we suggest that, for certain cases as we described above, an analysis of market competition or anticompetitive harm could serve as a useful indicator for the fairness of the transactions.