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Regulating the Visible Hands: Development of Rules on State-Owned Enterprises in Trade Agreements*

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The rise of modern state capitalism has cast doubt on the current global economic system and its assumption of a clear division between state and market. At the core of this systemic challenge are the state-owned enterprises of the 21st century. Unlike their predecessors, the state-owned enterprises of today have been transformed into powerful tools for global competition, shrouded under corporate veils. With the existing legal framework both unyielding and unprepared to accommodate these new developments, the momentum for reform soon reached its zenith. The Trans-Pacific Partnership's chapter on state-owned enterprises, the first stand-alone chapter on the subject, should be analyzed in this context. It consolidates and updates preexisting rules by introducing a bright-line definition of what state-owned enterprises are and incorporates tools to enhance the enforceability of the rule. Despite the significant accomplishments of the new rule and the rationale for the changes, the rule suffers from several shortcomings. This Note provides a legal analysis and critical evaluation of the rule, focusing on how it departs from the preexisting rule and highlights the factors that undermine its effectiveness. To breathe life into this theoretical analysis and evaluation, the Note also provides a case study of how the rule will affect a potential new entrant, South Korea.

> The invisible hand of the market is giving way to the visible, and often authoritarian, hand of state capitalism.
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> —The Economist, The Visible Hand (Jan. 21, 2012)

I. Introduction

The negotiations for the Trans-Pacific Partnership ("TPP") finally came to an end on October 5, 2015.[1] If fully enforced, the Partnership among 12 countries in the Asian-Pacific region will be the largest regional trade deal

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1. *See, e.g.,* John Kerry, The U.S. Secretary of State, *Press Statement: Successful Conclusion of Trans-Pacific Partnership (TPP) Negotiations* (Oct. 5, 2015), http://www.state.gov/secretary/remarks/2015/10/247870.htm. The legally verified text of the TPP was released on 26 January 2016. For the full text of the legally verified version, see *Text of Trans-Pacific Partnership*, New Zealand Foreign Affairs and Trade, https://www.mfat.govt.nz/en/about-us/who-we-are/treaties/trans-pacific-partnership-tpp/text-of-the-trans-pacific-partnership.

in history and is anticipated to have an immense effect on the regulatory architecture of the region.[2]

One of the novel features of the TPP that has drawn the attention of decision-makers in the region is Chapter 17 of the agreement, a stand-alone chapter on state-owned enterprises ("SOEs").[3] Considering the region's historical dependence on strong government presence, it comes as no surprise that the "TPP or not" debates have quickly gravitated towards the interpretation of the SOE chapter.[4]

It remains to be seen whether the Partnership will survive or face an early demise.[5] Even in the latter scenario, however, the TPP's SOE chapter will continue to be relevant for a number of reasons. First, the issues underlying the TPP will likely outlive the TPP itself. The very issues that brought the 12 countries to the negotiating table, including the SOE issue, will continue to raise challenges to the current international trade system. The fall of the

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2. The signing parties make up nearly 40% of the world's gross domestic product. *See* Tim Worstall, Opinion, *The TPP, World's Largest Trade Pact, Finally Gets Signed*, FORBES, Feb. 4, 2016, http://www.forbes.com/sites/timworstall/2016/02/04/the-tpp-worlds-largest-trade-pact-finally-gets-signed/#37cb14164062.

3. Trans-Pacific Partnership Ch. 17, Feb. 4, 2016, UNITED STATES TRADE REPRESENTATIVE, https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text [hereinafter TPP].

4. Interview with Professor Dukgeun Ahn, Professor of International Trade Law and Policy, Graduate School of International Studies, Seoul National University and Chairman of the TPP Strategy Forum, Ministry of Trade, Industry and Energy, South Korea in Seoul, South Korea. (Jan. 7, 2016).

5. At the time of this writing, the future of the TPP is uncertain at best. The main factor causing the uncertainty is the rapidly changing political landscape in the United States and the varying degree of credibility given to President-elect Trump's pledge to pull out from the Partnership. *See* Donald Trump, *A Message from President-Elect Donald J. Trump*, YOUTUBE (Nov. 21, 2016), https://www.youtube.com/watch?v=7xX_KaStFT8 (explaining his plan "to issue a notification of intent to withdraw from the Trans-Pacific Partnership, a potential disaster for our country," on the first day of his presidency). *Compare*, *e.g.*, Kavaljit Singh, *The TPP is Dead. What Happens Next?*, WIRE, Nov. 25, 2016, http://thewire.in/82522/the-tpp-is-dead-what-happens-next (explaining that "the TPP, in its present form, is effectively dead"), *with, e.g.*, Prashanth Parameswaran, *How TPP Can Survive Trump*, DIPLOMAT, Nov. 17, 2016, http://thediplomat.com/2016/11/how-tpp-can-survive-trump (explaining that it may be "too soon to bury the TPP" and exploring various scenarios that would allow the TPP to "survive even after Trump," such as: (1) renegotiating the TPP; and (2) other signatories initially moving forward with TPP without the United States). How other existing signatories will react adds another layer of complication. *Compare*, *e.g.*, Kiyoshi Takenaka, *Japan PM Says TPP Trade Pact Meaningless Without U.S.*, REUTERS, Nov. 21, 2016, http://www.reuters.com/article/us-japan-tpp-abe-idUSKBN13G2IK (Japan's Prime Minister Abe saying that "[t]he TPP would be meaningless without the United States"), *with, e.g.*, Marie-Danielle Smith, *TPP is Not 'Completely Dead,' Japan's Ambassador to Canada Says*, CALGARY HERALD, Nov. 24, 2016, http://www.calgaryherald.com/news/national/98completely†ead+japan+ambassador©anada§ays/12430238/story.html (hinting Japan's willingness to take the leadership role in moving the TPP forward); Primrose Riordan, *TPP Could be Renegotiated to Allow US Exit, Steve Ciobo Says*, FINANCIAL REVIEW, Nov. 22, 2016, http://www.afr.com/news/tpp-could-be-renegotiated-to-allow-us-exit-steve-ciobo-says-20161122-gsuu8b#ixzz4RFQiAxJO (showing Australia's willingness to move the deal forward, even if it would mean "renegotiating a less ambitious version of the . . . trade deal without the [United States]—potentially involving China or Indonesia"); Grace Leong, *Singapore Remains Committed to Ratifying TPP: MTI*, STRAITS TIMES, Nov. 23, 2016, http://www.straitstimes.com/business/economy/singapore-remains-committed-to-ratifying-tpp-mti (reaffirming Singapore's commitment to finding a way forward to ratify the TPP).

TPP, as a result, will beg for yet another attempt to address the unresolved issue.

Second, the TPP is one of the latest attempts to address the issue, built upon the lessons learned from the past. Analyzing and evaluating the TPP's SOE rule will provide a useful blueprint for future negotiations. As a descriptive matter, the TPP is just one of the various places where countries are negotiating to address the issues surrounding SOEs. For instance, the negotiating parties of the Transatlantic Trade and Investment Partnership ("TTIP"), another mega-arrangement between the United States and the European Union, have discussed the potential inclusion of an SOE chapter.[6] Although the TTIP may well end up adopting a rule that differs from the TPP's SOE chapter, the latter will at least provide a useful benchmark.[7] Another example is the ongoing negotiation process for Trade in Services Agreement ("TiSA"). In this mega-arrangement on trade in services, the TPP's SOE chapter has provided the basis for a recent proposal.[8] There are various other areas where the TPP's SOE chapter will likely serve as a useful blueprint.[9]

On the other hand, if the TPP does survive, there are reasons to think that the repercussions of the TPP's SOE rule will ultimately reach beyond the nominal territory of the TPP. The Partnership takes the form of an "open platform," leaving its door open to latecomers.[10] Several major economies in East Asia that initially opted out are considering the option of becoming the thirteenth member. As of today, South Korea ("Korea"), Indonesia, Thailand and the Philippines have expressed interest in joining the TPP.[11] Given

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6. *See, e.g.*, *EU Outlines Vision On Competition Issues In TTIP, Including On SOEs*, 31(28) Inside U.S. Trade, Jul. 12, 2013 at 16–17.

7. Even the initial proposal from the European Union, which differs in some ways from the TPP's SOE chapter, maintains the basic structure of the latter. *See* European Union, Textual Proposal: Possible Provisions on State Enterprises and Enterprises Granted Special or Exclusive Rights and Privileges (Jan. 7, 2015), http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153030.pdf (initial proposal for the legal text on SOE in TTIP). Just like the TPP's SOE chapter, the proposal defines a state enterprise based on quantifiable proxies, such as government ownership. *Id.* at art. 1(a). Further, the proposal provides a list of legal obligations to be imposed on state enterprises and the list closely tracks that in the TPP's SOE chapter. *See id.* at arts. 4 (non-discrimination), 5 (commercial consideration), 7 (transparency and corporate governance). The Note will analyze the TPP's SOE chapter in depth *infra* Part II.

8. *See* Rachel F. Fefer, Cong. Research Serv., R44354, Trade in Services Agreement (TiSA) Negotiations: Overview and Issues for Congress 9 (2016), https://www.fas.org/sgp/crs/misc/R44354.pdf.

9. *See* Donald Trump, *supra* note 5 (showing his interest in negotiating other "fair bilateral trade deals"); *see also* K. William Watson, *State-Owned Enterprises and the TPP*, Cato Liberty, Sept. 14, 2016, https://www.cato.org/blog/state-owned-enterprises-tpp (explaining that the TPP's SOE chapter has "real value in the long run, because [it] will provide a blueprint for future negotiations involving China").

10. Michael Froman, The U.S. Trade Representative, *Remarks at the U.S. Council for International Business Annual International Leadership Award Dinner* (Nov. 19, 2014), https://ustr.gov/about-us/policy-offices/press-office/speeches/2014/November/Remarks-by-Ambassador-Froman-at-USCIB-Annual-International-Leadership-Award-Dinner.

11. *See, e.g.*, Kwanwoo Jun, *South Korea Reiterates Interest in Trans-Pacific Partnership*, Wall St. J., Oct. 5, 2015, http://www.wsj.com/articles/south-korea-reiterates-interest-in-trans-pacific-partnership-1444057143; *see also* Astro Awani, *Thailand, Philippines and Indonesia Might Join TPP, Says MITI*, Malay-

the potential effect of the new rule, understanding its mechanics and assessing its potential benefits will be critical to learning the new grammar of international trade.

Mindful of the significance of the new rule, this Note seeks to accomplish four related goals. First, it provides the theoretical and practical context that led to the development of a new SOE rule. Part II will address this issue in detail.

Second, it analyzes how the new rule departs from the old ones.[12] Despite being rooted in frustration with the old rules, the new SOE chapter did not come out of thin air as a new invention. Most of the rules draw heavily from their predecessors but modify them as necessary. Accordingly, they reflect the experiences and conceptual assumptions of the past. For instance, the new rule draws heavily from bodies of World Trade Organization ("WTO") law, as well as some of the most advanced Free Trade Agreements ("FTAs"). This, of course, does not make the rule same as the old ones. On top of the familiar architecture, the new rule adds various measures mainly to enhance its administrability and enforceability. The most striking shift pertains to its clear-cut definition of an SOE and the extensive legal obligations that attach to the SOEs. Part III will analyze the new rule in depth, focusing on how it modifies a country's commitments under the existing rules.

Third, the Note critically assesses the effectiveness of the new rule. Despite its significant accomplishments, the new rule suffers from several shortcomings. Among others, the Note points to the lack of a consistent legal theory that the rule adopts with respect to the identity of SOEs. Because the new rule targets the shared characteristics of the currently-existing SOEs rather than defining the problem it seeks to solve, it does not provide sufficient guidance to deal with attempts to circumvent the rule through formalistic restructuring. The Note also argues that the prophylactic nature of the rule implicates the risk of being over- and under-inclusive. By choosing to define SOEs based on quantifiable proxies, such as government ownership, the rule exposes itself to a higher probability of false positives (cases where an enterprise that does not raise the problems typically associated with SOEs will be "captured" by the rule as an SOE) and false negatives (cases where an enterprise that does raise the problems typically associated with SOEs will "escape" the rule as a non-SOE). The issue associated with the over- and under-inclusiveness of the rule is aggravated by the fact that the rule takes an all-or-nothing approach, where any entity which does not rise to the level stipulated in the rule will *never* be considered an SOE. These two features, together, will create incentives for SOEs to merely restructure their problems around the rule, rather than solving them. Further, the Note

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SIAN DIGEST, Jan. 14, 2016, http://malaysiandigest.com/frontpage/29-4-tile/589881-thailand-philippines-and-indonesia-might-join-tpp-says-miti.html.

12. As discussed *infra* Part II, the old regime that used to address the issue of SOEs was made up of a mix of disparate rules.

argues that the political compromises that were likely necessary for the deal to succeed will result in loopholes in the new rule, further undermining its stability. Part IV will provide the critical evaluations in detail.

Admittedly, analysis and evaluation at this early stage of the rule must remain largely theoretical, if not hypothetical. To breathe life into this analysis, this Note provides a projection of how the new rule will affect a potential new entrant, Korea. Korea has shown great interest in joining the Partnership since the conclusion of negotiations. Despite a decades-long history of privatization, the public sector plays a pivotal role in Korea's economy, mainly in the form of "public institutions." These institutions remain influential in all corners of society, ranging from pop culture to banks. Because the legal definition of the public institutions is different from that of SOEs, assessing the cost of complying with the TPP's SOE rule must begin by determining which public institutions, if any, constitute SOEs. The next step is to determine what substantive obligations or exemptions apply to the respective SOEs. Part V will provide a case study of how the new rule will affect Korea if it becomes a party.

II. Putting SOE Issues in Context: Why Do We Need a New Rule?

Let us begin by addressing a fundamental question: Why are SOEs problematic in the international trade context? Many studies pre-dating the conclusion of the TPP point to the then-ongoing rounds of negotiations as potential fora to address the concerns regarding SOEs.[13]

On the one hand, the specter of state capitalism competing with purely private firms seems to provide an intuitive answer. A state distorting the market to benefit its SOEs to the detriment of their competitors, the argument goes, is unfair and sub-optimal.[14]

13. For an article pointing to the TPP negotiation to address SOE issues in general, see Tsuyoshi Kawase, *Trans-Pacific Partnership Negotiations and Rulemaking to Regulate State-Owned Enterprises*, Research Institute of Economy, Trade and Industry (Apr. 22, 2014), http://www.rieti.go.jp/en/special/policy-update/053.html. For articles pointing to the TPP as a potential forum to address country-specific issues related to SOEs, see Mark Wu, *The 'China, Inc.' Challenge to Global Trade Governance*, 57 Harv. Int'l L. J. (forthcoming 2016) (focusing on China's SOEs); *see also* Ming Du, *When China's National Champions Go Global: Nothing to Fear but Fear Itself?* 48(6) J. World Trade 1127, 1165 (2014) (focusing mainly on Chinese SOE issues); Thi Anh Nguyet Le, *State-owned Enterprise Reforms in the TPP Negotiation: Is It a Win-win for Vietnam?*, RIETI Discussion Paper Series 15-E-092 (2015) (focusing on Vietnam's SOEs). There have been several preliminary evaluations after the full text of the TPP was revealed as to how the SOE chapter under the TPP will address these concerns. *See, e.g.*, Ines Willemyns, *Disciplines on State-owned Enterprises in TPP: Have Expectations Been Met?* (Leuven Ctr. for Global Governance Studies, Working Paper No. 168, 2016); Asian Trade Center, *TPP Impressions: Competition and State Owned Enterprises (SOEs)*, Talking Trade Blog (Nov. 17, 2015), http://www.asiantradecentre.org/talkingtrade/2015/11/17/tpp-impressions-competition-and-state-owned-enterprises-soes.

14. *See, e.g.*, Coalition of Services Industries & U.S. Chamber of Commerce's Global Regulatory Cooperation Project, "21st Century" Trade Issues: The Challenges to Services Trade and Investment from State-owned/assisted Enterprises, Restrictions on Data Flows, and Forced Localization, 2011 Global Services Summit: Engaging the Dynamic Asian Economies 3–7 (July 2011), http://

The notion of so-called "competitive neutrality" has formed the undercurrent of the movement toward SOE reform and/or regulation.[15] The proponents of a new rule have largely focused on the benefits and preferential treatment that the SOEs receive and, consequentially, the uneven playing field that their privately-owned competitors face.[16] An oft-quoted list of this preferential treatment includes: outright subsidization, concessionary financing and guarantees by the government and/or governmental financial institutions, preferential treatment in the application of regulations, monopolies and advantages of incumbency, captive equity, exemption from bankruptcy rules, and information advantages.[17]

The "competitive neutrality" argument, however, has not gone without criticism. Some studies, for instance, argue that the competitive neutrality argument is not convincing because there are various societal roles that are imposed on or are expected from the SOEs that are not equivalently required of or expected from their privately-owned counterparts.[18]

Despite its importance, this Note sidesteps the thorny question of "who is right." Instead, the Note assumes that the concerns raised by the competitive neutrality argument are valid and evaluates the policy tools that are intended to address them. Even assuming that SOEs are causing real problems to global trade, whether or not they warrant the creation of a new rule is a separate issue altogether. Do current regulations address the competitive neutrality concerns at all? If they do, why do we need a new rule? There are three main reasons, which will be discussed in more detail: (1) first, the SOEs have gone through qualitative and quantitative transformations in the past decades; (2) second, the existing rules were not well suited

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www.esf.be/new/wp-content/uploads/2011/09/Global-Services-Summit-2011-Paper-on-21st-Century-Trade-Issues.pdf (discussing the "distortion of competition created by foreign government policy measures favoring [SOEs,]" such as regulatory favoritism, preferential purchasing and financial support).

15. *See, e.g.*, *Australia Eyes Enforceable SOE Rules that Extend to Sub-Central Level*, 31(11) Inside U.S. Trade, Mar. 15, 2013, at 8–9 ("U.S. business groups, led by the U.S. Chamber of Commerce and the Coalition of Service Industries, have also pressed the U.S. government to incorporate the concept of 'competitive neutrality' into TPP . . .").

16. *See, e.g.*, Antonio Capobianco & Hans Christiansen, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options* (OECD Publ'g, OECD Corp. Governance Working Paper No. 1, 2011); Kawase, *supra* note 13; Eduardo Pérez Motta, *Competition Policy and Trade in the Global Economy: Towards an Integrated Approach* 11 (E15 Expert Grp. on Competition Policy and the Trade System, Policy Options Paper, 2016).

17. *See, e.g.*, Antonio Capobianco & Hans Christiansen, *supra* note 16, at 5–7.

18. *Compare* 2011 Global Services Summit: Engaging the Dynamic Asian Economies, *supra* note 14, *with, e.g.*, Ha-Joon Chang, *State-owned Enterprises Reform*, (U.N. Dep't for Econ. & Soc. Affairs, National Development Strategies Policy Notes, 2007). Understandably, as we broaden the scope of the issue that pertains to SOEs, the differences in positions become less linear. There are various other reasons why one may argue that the rise of SOEs raise more problems than benefits. *See, e.g.*, Santosh Pande, *Listed State Owned Enterprises (SoEs) and the Treatment of Minority Shareholders – Case Studies from India* (Feb. 26, 2015), http://ssrn.com/abstract=2570888 (discussing minority shareholder issues in the SOEs); Ken Brown & Tom Wright, *Malaysia's 1MDB Decoded: How Millions Went Missing*, Wall St. J., (Nov. 22, 2015), http://graphics.wsj.com/1mdb-decoded (covering scandals related to Malaysia's state-owned fund). For a more comprehensive discussion, see, for example, Przemyslaw Kowalski et al., *State-Owned Enterprises: Trade Effects and Policy Implications* (OECD Trade Comm., Policy Paper No. 147, 2013).

for the new SOE characteristics; and (3) third, the adjudicatory body at the WTO refused to take an adaptive interpretation of the rule.

A. *The Rise of Visible Hands: SOEs in the 21st Century*

In the recent decades, SOEs have gone through a series of qualitative and quantitative transformations. First, the SOEs in the 21st century have incorporated so many features traditionally associated with privately-owned entities that it has become much harder to distinguish them from their non-SOE competitors. Many of them act exactly like any other enterprise, engaging in a wide variety of for-profit activities, and many are listed on major stock exchanges.[19] Second, SOEs in the 21st century have grown into some of the world's largest corporate giants, with their aggregate share of the world trade sharply increasing. The proportion of SOEs among the Fortune Global 500 has grown from 9% in 2005 to 23% in 2014.[20] Third, SOEs have earned a much greater global influence, growing beyond national borders and expanding activities globally. In today's closely-knit global society, SOEs take up a significant portion of international trade and foreign market investment. Currently, the value of their sales represents about 19% of the value of global flows of goods and services.[21]

At the core of these transformations are Chinese SOEs. With the combination of state ownership, state favoritism and informal ties, the rise of "China, Inc." has dismantled the preexisting understanding of the state-market division.[22] In addition to blurring the line that had traditionally existed between SOEs and non-SOEs, the Chinese SOEs have become some of the largest corporations in the world. In fact, the rapid increase in the proportion of the SOEs in Fortune Global 500 is almost entirely accounted for by Chinese SOEs.[23] Whereas Chinese SOEs took up only 3% of the 500 in 2005, they accounted for 15% in 2014.[24] Further, Chinese SOEs are increasingly knocking on the door of the world market through exports and investment, both directly and indirectly. The vast majority of subsidy investigations in the United States involve Chinese SOEs.[25] These SOEs have also

19. *See, e.g.*, Wu, *supra* note 13 (manuscript at 10–11); *see also* Curtis J. Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 Geo. L. J. 665, 673–74 (2015).

20. PWC, *State-Owned Enterprises: Catalysts for Public Value Creation*? Public Sector Research Ctr. 9 (2015), http://www.pwc.com/gx/en/industries/government-public-services/public-sector-research-centre/publications/state-owned-enterprises.html. Note that the source uses the OECD definition of SOEs, which include not only enterprises where the state has significant control through full or majority ownership, but also through significant minority ownership. *Id.* at 4 n.1.

21. Kowalski et al., *supra* note 18 at 30.

22. *See, e.g.*, Wu, *supra* note 13 (manuscript at 22).

23. For list of Global Fortune 500, see http://beta.fortune.com/global500; *see also* PWC, *supra* note 20, at 9.

24. *Id.*

25. Subsidies Program Since 2007, U.S. Dep't of Commerce International Trade Administration, https://esel.trade.gov/esel/groups/public/documents/web_resources/esel_home.hcsp (follow "Published Since 2007" hyperlink; then follow "search" hyperlink).

played a significant role in the dramatic increase in Chinese outbound foreign direct investment ("OFDI") in recent years.[26] All of these, taken together, have caused an unprecedented level of concern among China's major importers, such as the United States.[27]

SOE issues are not limited to China. Other Asian economies like Singapore, Vietnam, Malaysia, India, Japan, and Korea have significant interests in the field. For instance, the OECD reports that "the countries where the largest SOEs continue to be located" are India, Russia, the United Arab Emirates, and Malaysia, as well as China.[28] This is partially substantiated by the fact that many of these countries exhaust the investigatory resources for illegal subsidies in the United States.[29] According to the data provided by the U.S. International Trade Administration, the most frequent targets in 2014 were China, India, Korea, Chinese Taipei, Malaysia, and Vietnam.[30] The list remained largely the same in 2015: China, Korea, India, Indonesia, Canada, Chinese Taipei, Malaysia, and Russia.[31]

B. The Existing Rules Under Pressure

The emergence of these new SOE characteristics has quickly raised several systemic issues in the operation of world trade. For instance, the pre-TPP rules regulating SOEs invariably begin with the threshold requirement that the conduct at issue be attributable to a state action. In today's market where state influence is scattered into thousands of enterprises in varying levels, often hidden behind the apparently innocuous veil of corporations, the assumption that a state action will be discernible from a purely commercial act on an administrative level is questionable at best.

The SOEs in their new forms and unprecedented size and influence quickly took advantage of this theoretical loophole and began putting stress on the existing legal disciplines. As a result, the threshold question of whether a state is behind a transaction has become quite costly to answer. With the existing rules largely unprepared for these developments, the in-

26. *See, e.g.*, Ming Du, *supra* note 13, at 1127–29.

27. *See, e.g.*, *id.* at 1137–42 (explaining how the United States is responding to the aggressive investments by Chinese SOEs through various measures including Committee on Foreign Investment in the United States ("CFIUS") reviews). For various responses from other Western countries towards the sharp increase in the Chinese OFDI, see *id.* at 1142–50 (analyzing the defensive responses by the relevant authorities in Australia, Canada and the European Union).

28. Motta, *supra* note 16, at 11.

29. Author, data drawn and curated from Subsidies Enforcement Office Website, *supra* note 25.

30. *Id.* Of course, only a subset of these subsidies investigations involved SOE issues.

31. *Id.* Interestingly, the number of investigations against China has decreased from 30 in 2014 to 13 in 2015. During the same period, the shares of India and Korea have increased from 5 to 7, and 5 to 8, respectively. Author, data drawn and curated from Subsidies Enforcement Office, *supra* note 29. An extensive study of the trend regarding the domestic investigation goes beyond the scope of this Note. I leave it for future researchers to explore whether the United States has indeed tried to frame subsidies problems as less of a "China issue" and accordingly to diffuse its investigatory efforts among a larger pool of countries.

vestigative authority had to resort to ad hoc efforts to address them.[32] Often, it had to bear the cost by conducting extensive research about the parties to the transaction to trace it back to the government authority.

The case of the U.S. Department of Commerce ("US DOC") investigations into the activities and structure of Chinese exporters provides a useful illustration. In its investigation of drawn stainless steel sinks imported from China, US DOC had to determine whether the Chinese exporter at issue—Guangdong Dongyuan Kitchenware Industrial Co., Ltd. ("Dongyuan")—had received subsidies from the Chinese government, or more broadly, government "authorities" within the meaning of section 771(5)(B) of Title VII of the Tariff Act of 1930.[33]

In order to trace the transaction back to government action, US DOC requested information from the Chinese government "regarding specific companies that produced the stainless steel coil that Dongyuan purchased . . . ."[34] Because the Chinese government simply responded that each producer from which Dongyuan had purchased stainless steel coil was "not majority government-owned," US DOC further requested information needed to substantiate the claim, asking for "ownership, management, and corporate governance" of the stainless steel coil providers.[35] In response, the Chinese government stated that "to the best of its knowledge, Dongyuan has only one input producer" that is "not majority Government-owned. . . ."[36] US DOC, in turn, concluded that China's response was incomplete, because it identified only the ultimate individual corporate owners of the producer, and "it failed to indicate *whether its individual owners, members of the board of directors, or senior managers, were* [*Chinese Communist Party*] *officials*."[37] In the face of an allegedly unwilling cooperator, the ultimate cost of investigation fell almost exclusively on the complaining party.

China is not the only example that shows how arduous it can be under the existing rule for investigative authorities to determine whether government action was involved in an apparently innocuous business transaction. In a case against Korea, US DOC had to determine whether the transfer of funds to various conglomerates in Korea—e.g. Daewoo International, POSCO, and GS Global—constituted an illegal subsidy from the Korean govern-

32. *See*, *e.g.*, Wu, *supra* note 13 (manuscript at 42).

33. Memorandum from Christian Marsh, Deputy Assistant Sec'y for Antidumping and Countervailing Duty Operations to Paul Piquado, Assistant Sec'y for Enforcement and Compliance, Issues and Decision Memorandum for Final Results of Countervailing Duty Administrative Review: Drawn Stainless Steel Sinks from the People's Republic of China 6 (Nov. 3, 2015), http://enforcement.trade.gov/frn/summary/prc/2015-28664-1.pdf.

34. *Id.*

35. *Id.*

36. *Id.* at 7.

37. *Id.* at 8 (emphasis added). The Chinese government responded to this by saying that the "questions regarding the role of [Chinese Communist Party] officials in the management and operations of the stainless steel coil producers were not relevant." *Id.*

ment.[38] In doing so, it had to go through relays of similar questions and answers as well as independent investigations to determine whether the various financial institutions that transferred the funds, such as Korea Development Bank ("KDB"), Korea Asset Management Company ("KAMCO"), Korea Export Insurance Company ("K-SURE"), Korea's Import-Export Bank ("KEXIM"), Korea Resources Corporation ("KORES"), and Korea National Oil Corporation ("KNOC"), constituted "authorities" within the meaning of section 771(5)(B) of the Act.[39]

These cases illustrate the specific difficulties that the new SOEs pose to the current system. First, despite its importance in answering the threshold question of whether a state government has anything to do with a transaction, information regarding state-ownership is not readily available or easy to obtain. Second, acquiring this information requires willing coordination from an unlikely cooperator—the government authority of the exporting country. If the government is in fact operating SOEs that have been involved in the transaction at issue, it has little incentive to disclose the requested information. Third, the available legal tools fail to provide the investigative authority an effective means to address the cost associated with the investigation efforts.

C. *Static Boundary of the Existing Rules*

Despite the disconnect between the existing rules and reality, the adjudicatory body of the WTO insisted on interpreting the rules narrowly. They chose not to give up the theoretical balance that the original negotiators struck between administrability and potential abuse of the rule.[40]

As illustrated above, one of the contexts in which the SOE issue poses threats to the current rules pertains to subsidies provided by a government or its equivalent—a "public body" in WTO legal parlance.[41] Despite this practical reason for interpreting the rules in a more adaptive way, the adjudicatory body of the WTO has recently reaffirmed the rules' static boundary, explicitly rejecting the U.S. argument that government-ownership may be a dispositive factor to make an entity a public body.[42]

38. Memorandum from Christian Marsh, Deputy Assistant Sec'y for Antidumping and Countervailing Duty Operations to Paul Piquado, Assistant Sec'y for Enforcement and Compliance, Decision Memorandum for the Preliminary Negative Determination: Countervailing Duty Investigation of Certain Cold-Rolled Steel Flat Products from Republic of Korea (Dec. 15, 2015) 25–30, http://enforcement.trade.gov/frn/summary/korea-south/2015-32222-1.pdf.

39. *Id.*

40. *See, e.g.*, *id.*

41. *See* Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14 [hereinafter SCM Agreement].

42. *See, e.g.*, Appellate Body Report, *United States—Countervailing Duty Measures on Certain Products from China*, WTO Doc. WT/DS437/AB/R (adopted Dec. 18, 2014) [hereinafter Appellate Body Report, *US—Countervailing Measures (China)*]; *see also* Appellate Body Report, *United States—Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India*, WTO Doc. WT/DS436/AB/R (adopted

The careful approach taken by the Appellate Body ("AB") of the WTO was a justifiable interpretation of the law. The notion of a public body has been understood as an entity that, although not institutionally a part of a government, still functions like one. The likely intent of the drafters was not to extend the bound of the government too widely. Even assuming that such an evaluation is true, however, it remains equally true that the new issues raised by SOEs were left unaddressed. Frustrated with new developments in SOEs as well as the recalcitrant position of the AB, the proponents of a new approach to SOE regulation began focusing on pushing ambitious rules in alternative fora.[43]

The main proponent behind the new, more effective SOE rule was the United States. While for the United States state-ownership had been considered a rather drastic means of intervention, SOEs had become an essential component in many other major economies.[44] Consequently, these countries were less enthusiastic about the reform. It comes as no surprise that Chapter 17 of the TPP, giving a clear legal definition of what SOEs are and imposing substantive obligations they must abide by, largely mirrors the original proposal initially submitted by the United States for the TPP negotiation.[45]

III. How Does the New Rule Depart from the Old Rules?

Part III analyzes how the new rule departs from the old ones.[46] The comparison will be focused on two features: (1) definitions of SOEs and (2) sub-

Dec. 8, 2014) [hereinafter Appellate Body Report, *US—Carbon Steel (India)*]. For more in-depth discussion, see *infra* Part III.A.

43. *See, e.g.*, *China Sets Two-Year Goal For Finishing BIT; Chamber Submits Input*, 32(6) Inside U.S. Trade, Oct. 10, 2014, at 6–7 (reporting on the request from the U.S. Chamber of Commerce to the Obama administration to negotiate a stronger SOE rule in the U.S.-China BIT).

44. For instance, by the end of 2012, the United States had just two enterprises in which the federal government had majority-ownership. *See* Organization for Economic Cooperation and Development (OECD), *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* 21, OECD Publishing (2014). These two enterprises had a combined market value of $100 million and employed just 1,045 employees. *See id.* Further, the ownership "reflected emergency actions and largely involved deliberate and timely divestment plans." *Id.* at n.4. In contrast, the government of France has majority-ownership in three enterprises that have a combined market value of more than $45 billion and employ over 165,000 employees. *See id.* at 18. Further, France has 11 other enterprises with more than 10% ownership by the government. Together, these 11 enterprises have market value of more than $167 billion and employ approximately one million employees. *See id.*

45. *See, e.g.*, *TPP SOE Talks Move Forward With Tabling Of Consolidated Text*, 31(8) Inside U.S. Trade, July 26, 2013, at 8–9 (describing the features of the original proposal submitted by the U.S. for the TPP negotiation in comparison with Australia's alternative proposal).

46. For other articles that provide an excellent analysis of the TPP's SOE chapter, see Mikyoung Yun, *An Analysis of the New Trade Regime for State-Owned Enterprises under the Trans-Pacific Partnership Agreement*, 20 J. East Asian Econ. Integration 3 (2016); Ines Willemyns, *Disciplines on State-owned Enterprises in TPP: Have Expectations Been Met?* (Leuven Ctr. for Glob. Governance Studies, Working Paper No. 168, 2016). This Note attempts to add to these articles a more detailed explanation of how the TPP departs from the preexisting legal framework, and an in-depth analysis of the practical implication of such a departure.

stantive obligations attached to the SOEs. In short, the new rule consolidates and updates the old ones with respect to both features.

There are certain pre-TPP rules that purport to "capture" SOEs and attach legal obligations to them. They used to be scattered in various multilateral agreements at the WTO, as well as in more customized trade agreements among a smaller number of countries. Most of these old rules, however, lacked a clear definition of what SOEs are and an enforcement mechanism to give incentives to countries to comply with the rules.

The new SOE rule under the TPP, on the other hand, consolidates the old ones into one stand-alone chapter. It also updates the rules by providing a bright-line definition for SOEs.

A. *Definition of SOE*

The pre-TPP rules lacked a clear-cut definition of what an SOE is, leaving each country no other option than to litigate each case. In the new era of scattered state-ownership, the lack of a clear-cut definition rendered the rule inapt to address the issues raised by SOEs. The new rule under the TPP takes a prophylactic approach, providing a clear-cut definition of SOEs at the risk of being over- and under-inclusive.

1. *Pre-TPP Rules*

a. Multilateral

There are several multilateral agreements under the WTO that potentially cover state-ownership of a non-governmental entity. In short, there are three recurring features arising out of a survey of these agreements. First, the definitions provided for the target entities are far from clear-cut. Thus, potential complainants would not be able to know *ex ante* whether their competitors fall within the scope of the rules. Second, when asked to fill the legislative gap, the adjudicatory body of the WTO has constantly interpreted the definitions as setting a multi-factorial standard, rather than a rule. Third, in doing so, the adjudicatory body has typically required parties to show that an entity was behaving so much like a state that it warrants attributing its conduct to the state.

Article XVII of the General Agreement on Trade and Tariff 1994 ("GATT") deals with a particular form of government involvement through state trading enterprises ("STEs").[47] Although the notion of an STE might not perfectly overlap with that of an SOE, there exists significant similarity between the two with regard to the issue of government intervention in the form of a legally separate body. Specifically, the STE rule deals with a situation where a WTO member state maintains a "[s]tate enterprise . . . or

47. *See* General Agreement on Tariffs and Trade art. XVII, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

grants to any enterprise, formally or in effect, exclusive or special privileges."[48]

The term, however, largely lacks a formal definition. Instead, there are notes and understandings attached to the article providing an indicative list.[49] Another suggestion of the definition can be found on the official website of the WTO, which provides its own illustrative list.[50] For SOE purposes, the official website does mention state-ownership as the defining factor of state enterprise.[51] Yet even in this case the required level of state ownership remains unexplained. As a result, as the WTO concedes, the entire rule is left without bite:

> Throughout the history of Article XVII, a major lacuna has been the absence of any clear definition of what a State trading enterprise is, or what State trading is. Many attempts were made at such a definition, but all of them failed. Needless to say, this was a serious handicap in the efforts to enforce the transparency obligation under Article XVII. How can you make a notification when you don't understand what it is you are supposed to be notifying? Thus, it is likely that many State trading enterprises of many countries went unreported for years. To further complicate this already unsatisfactory situation, very few contracting parties to GATT complied with the notification requirement to make a notification annually, even where there were no STEs to report.[52]

The lack of clear definition does not mean that the definition is not litigable. The adjudicatory body at the WTO has had opportunities to further draw the bounds of the concept of the STE. It too took an incremental approach, considering the totality of the facts before it, rather than devising a bright line rule for all cases.[53]

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48. *Id.* at 1(a).

49. *See id.* at *Ad* art. XVII, para. 1 (mentioning marketing boards as one example); *see also* Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994, General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187 [hereinafter GATT 1994], at para. 1 (further explaining STEs as "Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports").

50. Technical Information on State Trading Enterprise, WTO, https://www.wto.org/english/tratop_e/statra_e/statra_info_e.htm (last visited Oct. 19, 2016, 10:54 PM) [hereinafter Technical Information on State Trading Enterprise]. The list includes: statutory marketing boards; export marketing boards; regulatory marketing boards; fiscal monopolies; canalizing agencies; foreign trade enterprises; and boards of nationalized industries. *Id.*

51. *Id.*

52. *Id.*

53. *See, e.g.*, Panel Report, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, ¶766, WTO Doc. WT/DS161/R (adopted July 31, 2000), [hereinafter Panel Report, *Korea—Various Measures on Beef*] (concluding that the producer-controlled import monopoly for beef was an STE to the extent that it "fully controls both the importation and distribution of its 30 per cent share of Korean beef quota").

The intended goal of the rule is one of its few points of clarity. The rule seeks to regulate a set of fact patterns where conduct of an entity that is formally separate from its government will still be attributed to the latter. The Appellate Body ("AB") in *Canada—Wheat Exports and Grain Imports* made clear that the definition was to prevent a circumvention by a government:

> Subparagraph (a) seeks to ensure that a Member cannot, through the creation or maintenance of a State enterprise or the grant of exclusive or special privileges to any enterprise, engage in or facilitate conduct that would be condemned as discriminatory under the GATT 1994 if such conduct were undertaken directly by the Member itself. In other words, subparagraph (a) is an "anti-circumvention" provision.[54]

The Agreement on Subsidies and Countervailing Measures ("SCM Agreement") is similarly ambiguous. The SCM Agreement regulates government provision of illegal subsidies.[55] Some SOE conduct can be effectively regulated under this rule, such as a government granting subsidies to an SOE (SOE-as-recipient), or an SOE functioning as a pass-through of a government subsidy, becoming its nominal provider (SOE-as-provider). For the purposes of tracing a definition of SOEs, we will focus here on the latter scenario.[56]

In the "SOE-as-provider" situation, it is uncertain whether and to what extent an entity legally distinguishable from the government can be a subsidy provider. Under the SCM Agreement, a direct transfer of funds can be defined as a subsidy only if it comes from the government or a "public body."[57] Understandably, great stress is put on the legal definition of this term of art. One controversy is whether SOEs, by definition, should be deemed to constitute public bodies. There is no uniform definition for "public body," however, as was the case regarding the STE provision above. Thus, it was again left to the adjudicatory body to take an incremental approach as cases came along.

The relevant jurisprudence shows that the AB insisted on drawing a malleable line, providing a multi-factor test to determine whether an entity constituted a public body, rather than making state-ownership a dispositive factor. In *United States—Countervailing Measures* (*China*), the issue was

54. Appellate Body Report, *Canada—Measures Relating to Exports of Wheat and Treatment of Imported Grain*, ¶85, WTO Doc. WT/DS276/AB/R (adopted Aug. 30, 2004) [hereinafter Appellate Body Report, *Canada—Wheat Exports and Grain Imports*].

55. SCM Agreement, *supra* note 41.

56. This focus is because the "SOE-as-recipient" scenario would not require defining SOEs since it suffices that the receiver was specific. *See* SCM Agreement, *supra* note 41, at art. 1.2.

57. *Id.* at art. 1.1(a)(1) ("For the purpose of this Agreement, a subsidy shall be deemed to exist if: there is a financial contribution by a government or any *public body* within the territory of a Member. . . .") (emphasis added).

whether the providers, in this case state-owned manufacturers and state-owned commercial banks, were, as the United States argued, public bodies.[58] If they were, their provision of benefits would have been considered an illegal subsidy. If not, the benefit would fall outside of the Agreement altogether. The AB ruled that the state-owned manufacturers were not public bodies, rejecting the argument by the United States that a majority-state-share of enterprise would demonstrate *per se* that the enterprise was indeed a public body.[59] Instead, the AB required that a public body determination follow consideration of whether the entity "possess[ed], exercise[ed], or [was] vest[ed] with governmental authority."[60] This question, according to the AB, would result in different answers depending on the domestic circumstances of the alleged subsidy provider:

> A public body within the meaning of Article 1.1.(a)(1) of the SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority. Yet, just as no two governments are exactly alike, the precise contours and characteristics of a public body are bound to differ from entity to entity, State to State, and case to case.[61]

According to the AB, the complaining party has to show more than majority-ownership by government: the ultimate question is whether the government has vested its authority and whether the enterprise actually functioned with government authority.[62] Indeed, the AB struggled with the ILC state action provision.[63]

The AB in *US—CVD Hot-Rolled Carbon Steel Flat Products from India* reaffirmed that proxies such as state ownership are merely evidence that may be considered to get to the question, not a reflection of government authority itself.[64] In this case, the AB ruled that the Indian government's 98% ownership did not necessarily qualify the company as a public body.[65]

58. Appellate Body Report, *United States—Definitive Anti-Dumping and Countervailing Duties, on Certain Products from China*, ¶ 317, WTO Doc. WT/DS379/AB/R (adopted Mar. 11, 2011) [hereinafter *US—Anti-Dumping and Countervailing Duties (China)*].

59. *Id.* at ¶¶ 318–22

60. *Id.* at ¶ 317.

61. *Id.*

62. *Id.* at ¶ 318 ("[T]he mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity, much less that the government has bestowed it with governmental authority.").

63. For an excellent analysis of the AB's (misguided) struggle with the state action concept in the context of the public body conundrum, see Jaemin Lee, *State Responsibility and Government-Affiliated Entities in International Economic Law*, 49(1) J. World Trade 117 (2015).

64. Appellate Body Report, *US—Carbon Steel (India)*, ¶¶ 4.17–4.30.

65. *Id.* at ¶ 4.52 ("[A] determination of whether a particular conduct is that of a public body 'must be made by evaluating the core features of the entity and its relationship to government' and 'must focus on evidence relevant to the question of whether the entity is vested with or exercises governmental authority.' The USDOC does not appear to have addressed these questions in its determinations.") (footnote omitted).

b. Plurilateral/Bilateral

From its early days, key users of bilateral trade arrangements, notably the United States, have shown interest in regulating the behavior of SOEs through FTAs. The agreements generally provide provisions directly addressing SOE conduct under their competition chapters. The provisions also tend to contain a legal definition of an SOE or its functional equivalent. When they do, they base their definition (1) on a combination of a delegation of governmental authority and government ownership/control; (2) solely on a delegation of governmental authority; or (3) solely on government ownership/control.

The North American Free Trade Agreement ("NAFTA") falls into the first category. NAFTA stipulates that the relevant rules of the agreement apply where an entity was delegated "governmental authority" and further meets the definition of a "state enterprise" provided in the agreement.[66] Governmental authority includes "the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees, or other charges."[67] The delegation can take place through "a legislative grant, and a government order, directive, or other act, transferring to the monopoly or state enterprise, or authorizing the exercise by the monopoly or state enterprise of, governmental authority."[68] In addition to proving that an enterprise was acting like a state with delegated authority, NAFTA requires that the entity is "owned, or controlled through ownership interests" by a state.[69] In sum, an entity will be deemed an SOE only when an entity simultaneously satisfies both the governmental authority and government ownership/control criteria.

The second category includes the U.S.-Australia FTA and the U.S.-Korea FTA.[70] These agreements define SOEs solely on the basis of the delegated governmental authority.[71] The delegated governmental authority definition tracks the AB's state-attribution approach. Once an SOE is found to be acting like a state with the delegated authority to do so, the SOE must assume the entire obligations that the state has under the agreement.[72] This is consistent with the state-attribution approach where the underlying theme is to prevent governments' circumvention that occurs through another entity.

66. North American Free Trade Agreement, Can.-Mex.-U.S., art. 1503.2–1503.3, Dec. 17, 1992, 32 I.L.M. (1993) [hereinafter NAFTA].

67. *Id.* at art. 1503.2.

68. *Id.*

69. *Id.* at art. 1505.

70. Free Trade Agreement, Austl.-U.S., Ch. 14, Oct. 10, 2014, United States Trade Representative, https://ustr.gov/trade-agreements/free-trade-agreements/australian-fta/final-text [hereinafter U.S.-Australia FTA]; Free Trade Agreement, S. Kor.-U.S., Ch. 16, Jun. 30, 2007, United States Trade Representative, https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text [hereinafter U.S.-Korea FTA].

71. *See*, *e.g.*, U.S.-Korea FTA, *supra* note 70, at art. 16.3.1(a).

72. *See*, *e.g.*, *id.* at art. 16.3.

For instance, the U.S.-Korea FTA provides that the legal obligations under the Agreement are triggered and applied to a "state enterprise" when such enterprise "exercises any regulatory, administrative, or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions, or impose quotas, fees, or other charges."[73]

The U.S.-Singapore FTA, meanwhile, is an archetype of the final category. The relevant provision of the U.S.-Singapore FTA defines "government enterprise" as "an enterprise in which that Party has effective influence."[74] Under the relevant article, there exists an effective influence when a government owns "more than 50 percent of the voting rights" or has "the ability to exercise substantial influence over the composition of the board of directors or any other managing body of an entity" in the decision-making process.[75] There exists a rebuttable presumption of effective influence even when the governmental ownership of voting rights constitutes less than the majority if the government, either by itself or in combination with its government enterprises, owns more than 20% and that constitutes the largest block of voting rights.[76] Further, the definition extends to an enterprise in which a government owns a special voting share with veto rights.[77] The scope is limited to an enterprise whose annual revenue or total assets are greater than SGD 50 million.[78] According to the final approach, it becomes irrelevant whether an entity actually has the authority to act like a state or it in fact acts like one. The government ownership or control replaces such a requirement.[79]

In sum, most of the pre-TPP bilateral and plurilateral trade agreements, except for the one between the United States and Singapore, have stemmed from the government-delegation approach. Even where state ownership has been included as an element, such as in NAFTA, again with the exception of

73. *Id.*

74. Free Trade Agreement, Sing.-U.S., art. 12.8.6, May 6, 2003, United States Trade Representative, https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset_upload_file708_4036.pdf [hereinafter U.S.-Singapore FTA].

75. *Id.* at art. 12.8.5.

76. *Id.* at art. 12.8.5(b).

77. *Id.* at art. 12.8.1.

78. *Id.* As of November 2016, SGD 50 million equaled about USD 35.3 million.

79. In contrast, the FTAs to which the United States is not a party generally fail to include a clear definition of SOE. For instance, the FTA between Korea and Singapore has provisions potentially covering the subject matter, but does not define what the parties mean by "government-owned businesses." Free Trade Agreement, Sing.-S. Kor., art. 15, Mar. 2, 2006, Singapore Government Agency International Enterprise Singapore, http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/FTA/Existing%20FTA/Korea%20Singapore%20FTA/Legal%20Text/KoreaSingapore20FTA20Legal20Text.pdf [hereinafter Korea-Singapore FTA]. In 2014, Japan and Australia concluded an Economic Partnership Agreement ("EPA," functionally equivalent to an FTA), which specifically addresses SOE under its competition chapter. Again, the chapter fails to define what SOE means. *See* Economic Partnership Agreement, Austl.-Jap., Jan. 15, 2015, Australian Government Department of Foreign Affairs and Trade, http://dfat.gov.au/trade/agreements/jaepa/official-documents/Pages/official-documents.aspx [hereinafter Australia-Japan EPA].

the U.S.-Singapore FTA, the agreements fail to provide a specific threshold level.

2. *TPP Rules*

The TPP represents a dramatic shift away from the extension of a state action theory championed by the governmental authority approach and largely followed by the earlier bilateral agreements. The TPP rule basically uses three proxies to determine whether an entity is a SOE: (1) the commercial nature of its activities; (2) the ownership and/or control by the state of the entity; and (3) the size of the enterprise.[80]

The TPP first requires that an SOE be an enterprise that is "principally engaged in commercial activities."[81] The treaty's definition of commercial activities requires three elements to be present: (1) the activities must be carried out for profit-making, not on a cost-recovery or not-for-profit basis;[82] (2) the activities must result in production of a good or supply of a service that will be sold to a consumer in the relevant market in quantities; and (3) the enterprise must be able to determine the price on its own.[83]

The TPP rule also requires that an SOE be an enterprise in which the state directly owns more than 50% of the share capital, or controls the exercise of more than 50% of the voting rights through ownership interests, or holds power to appoint more than 50% of board members.[84]

Even when an enterprise meets both of these proxies, it must have an annual revenue derived from commercial activities of more than 200 million Special Drawing Rights ("SDRs") in any one of the three previous consecutive fiscal years, adjusted for inflation.[85] SDRs are a monetary unit set by the International Monetary Fund ("IMF"). As of November 14, 2016, 200 million SDRs equaled about $146,675,000.[86]

It is equally important to note that the rule excludes a substantial list of entities that would otherwise have fallen into the rule's scope: a central bank or monetary authority performing regulatory or supervisory activities or conducting monetary and related credit policy and exchange rate policy;[87] a financial regulatory body such as a securities and futures exchange or market, clearing agency, or other organization or association exercising regulatory or supervisory authority over financial services suppliers;[88] SOEs

80. TPP, *supra* note 3.
81. *Id.* at art. 17.1.
82. *Id.* at art. 17.1 n.1.
83. *Id.* at art. 17.1.
84. *Id.* at art. 17.1.
85. *Id.* at art. 17.13.5; *see also id.* at Annex 17-A. For Brunei, Malaysia and Vietnam, the minimum threshold is 500 million SDRs instead of 200 million. *See id.* at n.35.
86. *SDRs per Currency unit and Current units per SDR last five days*, IMF, (November 14, 2016) https://www.imf.org/external/np/fin/data/rms_five.aspx. TPP, *supra* note 3, at art. 17.2.2.
87. *Id.*
88. *Id.* at art. 17.2.3.

undertaking activities for the purpose of resolving matters for failing or failed financial institutions or any other failing or failed enterprises principally engaged in the supply of financial services.[89]

Further, Annex IV to the TPP includes extensive carve-outs for a sub-set of parties.[90] Countries that have included party-specific carve-outs not only include East Asian countries like Brunei, Malaysia, and Vietnam, but also include the United States, Australia, Canada, Chile, Mexico, New Zealand, and Peru.[91] One important note is that the Annex generally names the specific entities that are being carved out. For instance, the U.S. carve-out includes various mortgage associations such as the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, and policy-directed financial institutions such as the Federal Financing Bank.[92] Japan has not included any of the party-specific carve-outs.[93] Party-specific carve-outs are analyzed *infra* Part III.B.2.e.

3. *Preliminary Analysis*

The new rule represents a significant shift from its parties' pre-existing commitments. As mentioned earlier, the proponents of the new rule faced three hurdles which undermined the relevancy and the applicability of the pre-TPP rules to the recent developments in world trade: the lack of a clear-cut definition provided *ex ante*, a standard, rather than a rule, provided *ex post*, and an implicit requirement of state action. The new rule under the TPP solves all three problems. By adopting a clear-cut rule based exclusively on quantifiable proxies to determine government control, the TPP better targets a specific set of entities that share a particular set of characteristics, regardless of their state-likeness.

The commercial activity requirement further eliminates uncertainties by substituting a grey area with a clear-cut binary. In effect, the rule automatically applies if an entity, which meets all the other requirements, is *principally* engaged in commercial activities. This pushes an enterprise into either of the mutually exclusive categories: activities of an entity are primarily commercial, or they are not. This reverses the long-held notion and concession that a grey zone between public and private activities exists, and that it is permitted to coexist with other private actors in a global market.

Other related rules that further tailor the scope of the definition of SOEs seem reasonable as well. The size requirement appears to be a rational cutoff

89. *Id.* at art. 17.2.4.

90. *See generally id.*, at Annex IV.

91. *Id.*

92. *Id.*

93. *Id.* This may come as a surprise considering that Japan has a number of SOEs that play significant roles in Japan's economy and politics, such as the Japan Post Service Co. Ltd. ("Japan Post"), especially since the vast majority of the parties have successfully obtained party-specific carve-outs. As will be discussed *infra* Part III.B.2.e., this puzzle is partially explained by the fact that the TPP contains sweeping exemptions for domestic service suppliers, such as Japan Post, from several substantive obligations.

to tailor the rule to deal with bigger problems without imposing the same burden across the board, considering that the size of the enterprises correlates with their involvement in the international transaction. Similarly, the carve-outs appear to be a set of rational options to avoid imposing undue burdens on innocuous entities, as well as to accommodate practical necessities.

As a final note, the SOEs are more narrowly defined under the TPP compared to some of the most advanced FTAs predating it. For instance, the U.S.-Singapore FTA provides several safe harbor provisions to capture situations where the majority government ownership fails to function as an effective proxy. Recall that to be an SOE under the TPP, an entity needs either the majority state ownership, or the state control through majority voting rights or rights to appoint the board members. Otherwise, the entity fails to be "captured" as an SOE, and "escapes" the rule. Under the U.S.-Singapore FTA, however, an entity in which the government has a minority share can still be an SOE if the government ownership exceeds 20%, and constitutes the largest block of voting rights of the entity.[94] It also provides that an entity can be an SOE if the government can determine the outcome of decisions on the strategic, financial or operating policies or plans of an entity, or otherwise exercise substantial influence over the management or operation of an entity, regardless of the formal requirements.[95]

B. *Legal Obligations of SOEs*

1. *Pre-TPP Rules*

a. *Multilateral*

There are three main sets of legal obligations in the multilateral context that have been applied to SOEs: commercial consideration requirements, prohibition of providing subsidies, and transparency-related requirements. Understandably, the key to all of these obligations is whether and to what extent they can be enforced against SOE conduct. Unfortunately, the rules have suffered severely from a lack of enforceability. Such a lack of enforceability has been most apparent in the context of administering the duty of transparency. This stems from two factors. First, the requirements lacked built-in enforcement measures. Enforcement was largely left to the grace and diligence of each state to determine the level of compliance. Second, as

94. U.S.-Singapore FTA, *supra* note 74, at art. 12.8.5(b) ("Where the government and its government enterprises, alone or in combination, own 50% or less, but more than 20%, of the voting securities of the entity and own the largest block of voting rights of such entity, there is a rebuttable presumption that effective influence exists.").

95. *Id.*

discussed *supra* Part III.A.1, the rules failed to provide a clear definition of their scope, further exposing them to abuses and operations that fell below best practices.

Under Article XVII of GATT, an entity found to be an STE can be subject to the doctrines of commercial basis and nondiscriminatory principles. The relevant provision requires that an STE "shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of *non-discriminatory treatment* . . . ."[96] It also specifies the duty to act in a nondiscriminatory manner to mean that an STE must act "solely in accordance with *commercial considerations*," based on the "price, quality, availability, marketability, transportation and other conditions" of the transaction.[97]

The AB later explained that the rules of nondiscriminatory treatment and the duty of commercial consideration are complementary, rather than codependent. In *Canada-Wheat Exports and Grain Imports*, the AB held that the two obligations can independently provide the bases for a breach.[98] Therefore, as long as STEs do not treat goods from another country in a discriminatory manner, the STEs can be deemed to have acted in accordance with commercial considerations and thus can make use of their privileges, which they do not have to undo in order to be said to be acting consistently with Art. XVII of GATT.

The legal obligations under the SCM Agreement apply to SOEs as well. The SCM Agreement not only prohibits certain subsidies provided to SOEs, but it also prohibits SOEs functioning as a nominal provider of subsidies, as long as they are proven to be acting as a "public body."[99]

Article XVII of GATT also imposes transparency requirements on STEs. All STEs must inform the WTO of their existence, as well as all the products over which they have any authority.[100] The current system also requires that member states disclose "the policy objectives for which the STE was established and continues to operate," together with "the legal authority that grants exclusive or special rights or privileges, if any."[101] Further, member states must explain the functioning of STEs, "all exclusive or spe-

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96. GATT, *supra* note 47, at art. XVII(1)(a) (emphasis added).

97. *Id.* at art. XVII(1)(b) (emphasis added). The addendum to Article XVII also adds that "charging by a state enterprise of different prices for its sales of a product in different markets is not precluded by the provisions of this Article, provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets." *Id.*

98. *See* Appellate Body Report, *Canada—Wheat Exports and Grain Imports* at ¶ 145 ("The disciplines of Articles XVII:1 are aimed at preventing certain types of discriminatory behavior. We see no basis for interpreting that provision as imposing comprehensive competition-law-type obligations on STEs, as the United States would have us do."); *see also id.* at para. 102 ("[C]onclusion that decision to purchase or buy was not based on commercial considerations would also suffice to show a violation of Article XVII." (quoting Panel Report, *Korea – Various Measures on Beef*)).

99. *See* SCM Agreement, *supra* note 41, at art. 1.1(a)(1), 3.1(a-b).

100. GATT, *supra* note 47, art. XVII(4)(a).

101. WTO, Technical Information on State Trading Enterprise, *supra* note 50.

cial rights or privileges" conferred to STEs, and "any other support or assistance provided by the government" to STEs, and other information aimed at allowing other member states to assess the validity of its "existence and function."[102] The questionnaire requires "every member state to furnish statistics" annually.[103] Further, member states must make a "complete response to the questionnaire" every two years.[104] If a member state has reason to believe that "another member has failed" to discharge its "notification obligation," it can make a counter-notification.[105]

Despite the extensive required annual questionnaires, the regime lacks effective enforcement mechanisms against prevalent noncompliance. Accordingly, combined with the uncertainties in the STE definition discussed *supra*, the transparency obligation was largely left to the grace and good faith of each member state.

The official website of the WTO concedes the high level of noncompliance:

> One of the main problems relating to State trading in the context of a rules-based international trading system is the lack of transparency of the existence and activities of State trading enterprises. While the obligation to notify such enterprises has been "on the books"—that is to say, in the General Agreement—since 1947, and the first deadline for such notifications was February of 1958, compliance with this obligation has been, until only very recently, very poor.[106]

Similar problems with respect to enforcing the legal obligations under the transparency rule can be found in the context of subsidies regulations. The SCM Agreement requires that Members report certain information on all measures that constitute subsidies under the Agreement, including those involving SOEs.[107] Under the Agreement, Members are also obligated to regularly provide a subsidy notification to the Subsidies Committee.[108] Although this framework has been effective to a certain extent,[109] it can be seen that the current regime is inadequate to address an allegedly high level

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102. *Id.*
103. *Id.*
104. *Id.*
105. *Id.*
106. WTO, Technical Information on State Trading Enterprise, *supra* note 50.
107. SCM Agreement, *supra* note 41, at art. 25.2–3.
108. *Id.* at art. 25.1. Further, Article 25.8 of the Agreement provides that "Any Member may, at any time, make a written request for information on the nature and extent of any subsidy granted or maintained by another Member . . . or for an explanation of the reasons for which a specific measure has been considered as not subject to the requirement of notification." *Id.* at art. 25.8. Under Article 25.9, Members are obligated to provide a response "as quickly as possible and in a comprehensive manner." *Id.* at art. 25.9.
109. The U.S. Trade Representative & U.S. Dep't of Commerce, Subsidies Enforcement Annual Report to the Congress 15 n.6 (2015).

of noncompliance by other countries.[110] For instance, frustrated with the alleged low level of compliance, the United States filed counter notifications for over more than 250 subsidy programs in China and India that the United States has alleged were unreported.[111] Such criticisms serve to highlight how SOEs exacerbate the lack of transparency.[112]

b. Plurilateral/Bilateral

FTAs that contain SOE regulations impose a set of substantive obligations on the relevant entities. The most advanced FTAs, such as between the United States and Singapore, impose a duty of commercial consideration and non-discrimination,[113] and a prohibition on anti-competitive conduct[114] on SOEs. The U.S.-Singapore FTA also requires that the Singaporean government not influence or direct decisions of its government enterprises in a manner inconsistent with the agreement, and continue to reduce its overall ownership and control of the enterprises.[115]

Further, the Singapore FTA contains extensive rules of transparency. Under the agreement, the Singaporean government must disclose, at least annually:

> (A) the percentage of shares and the percentage of voting rights that Singapore owns, and its government enterprises cumulatively own;
> (B) a description of any special shares or special voting or other rights that Singapore or its government enterprises hold, to the extent that they differ from the rights attached to the general common shares of such entities;

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110. *See id.* at 9.

111. *Id.* at 16.

112. *Id.* at 9 ("China has a poor record of compliance with the WTO transparency obligations . . . China maintains a largely opaque industrial support system and appears to have employed numerous subsidies—as an integral part of industrial policies designed to promote or protect its SOEs . . . .").

113. U.S.-Singapore FTA, *supra* note 74, at art. 12.3.2(d)(i) (requiring that a government enterprise "act[ ] solely in accordance with commercial considerations in its purchase or sale of goods or services, such as with regard to price, quality, availability, marketability, transportation, and other terms and conditions of purchase or sale, and provides non-discriminatory treatment to covered investments, to goods of the United States, and to service suppliers of the United States, including with respect to its purchases or sales").

114. *Id.* at art. 12.3.2(d)(ii)(A)–(B) (requiring that a government enterprise not "enter into agreements among competitors that restrain competition on price or output or allocate customers for which there is no plausible efficiency justification, or engage in exclusionary practices that substantially lessen competition in a market in Singapore to the detriment of consumers").

115. *Id.* at art. 12.3.2(e)–(f) ("Singapore shall take no action or attempt in any way, directly or indirectly, to influence or direct decisions of its government enterprises, including through the exercise of any rights or interests conferring effective influence over such enterprises, except in a manner consistent with this Agreement. However, Singapore may exercise its voting rights in government enterprises in a manner that is not inconsistent with this Agreement.

Singapore shall continue reducing, with a goal of substantially eliminating, its aggregate ownership and other interests that confer effective influence in entities organized under the laws of Singapore, taking into account, in the timing of individual divestments, the state of relevant capital markets.").

> (C) the name and government title(s) of any government official serving as an officer or member of the board of directors; and
> (D) its annual revenue or total assets, or both, depending on the basis on which the enterprise qualifies as a covered entity.[116]

In contrast, other FTAs generally take an approach that the same set of obligations applicable to a party's government shall be imposed in their entirety to its SOEs once it is found to be acting as an alter ego of the government. For instance, the relevant part of the U.S.-Korea FTA stipulates that the parties' state enterprises shall act "in a manner that is not inconsistent with the Party's obligations under this Agreement" if the enterprises meet the definition mentioned *supra* Part III.A.1.b. At first blush, this sounds like a more sweeping commitment compared to the FTA between the United States and Singapore, where their government enterprises are subject to a set of more particularized rules. However, considering that the threshold applicable to Korea's "state enterprises" is much higher and more ambiguous than that applicable to Singapore's "government enterprises," the sweeping rule means little in practice.

Furthermore, Korea's FTA with the United States imposes a set of transparency rules. At the request of one party, the other party has an obligation to provide information regarding "state enterprises and designated monopolies, public or private, at any level of government"[117] as well as "exemptions and immunities to its competition laws."[118] Unlike Singapore's case, however, the U.S.-Korea FTA puts a substantial burden on the requesting party to obtain the information. For instance, the Agreement requires that the information request for state enterprises be specific and "include[ ] some indicia that these entities may be engaging in practices that may hinder trade or investment between the Parties."[119] Similarly, it requires that the request for exemptions and immunities "include[ ] indicia that the exemption or immunity may hinder trade or investment between the Parties."[120]

2. *TPP Rules*

Once an enterprise qualifies as an SOE, the TPP rule imposes on it several substantive obligations.

(1) Commercial consideration

First, the obligation of commercial consideration mandates that an SOE act "in accordance with commercial considerations in its purchase or sale of

116. *Id.* at art. 12.3.2(g).
117. U.S.-Korea FTA, *supra* note 70, at art. 16.5.2(b).
118. *Id.* at 16.5.2(c).
119. *Id.* at 16.5.2(b).
120. *Id.* at 16.5.2(c).

good or service."[121] Commercial consideration refers to "price, quality, availability, marketability, transportation, and other terms and conditions of purchase or sale, or other factors that would normally be taken into account in the commercial decisions of a privately owned enterprise in the relevant business or industry."[122]

(2) Non-discrimination

Second, it must not discriminate against goods and services of another party. The language includes both national treatment and most favored nation treatment. Hence, the parties must provide treatment "no less favorable than it accords to a like good or a like service supplied by enterprises of the Party, of any other Party, or of any non-Party."[123]

(3) Non-commercial Assistance

Third, the rule also restricts (1) provision of assistance to SOEs, either from the government or another SOE, by virtue of that SOE's government ownership or control that (2) causes an adverse effect or injury to trade and investment interests to other TPP members. In effect, this provision regulates subsidies provided specifically to SOEs. As long as the recipient is an SOE, the rule applies to any assistance with respect to both goods-producing SOEs and service-supplying SOEs.[124] This regulation is one of the novel inventions of the TPP rule, considering that the pre-TPP rules generally have not regulated subsidies to service suppliers.[125]

The first part of the rule on non-commercial assistance ("NCA") refers to an array of assistance, including: assistance limited only to SOEs; assistance predominantly used by SOEs; a disproportionately large amount of assistance provided to SOEs; favoritism in the provision of assistance to SOEs.[126] Assistance can take the form of direct transfers of funds or liabilities, such as: grants or debt forgiveness; loans or loan guarantees or other types of

121. TPP, *supra* note 3, at art. 17.4.1(a).

122. *Id.* at art. 17.1. The rule provides a conditional exception for any public service mandate that the SOE has to fulfill. *See*, *e.g.*, *id.* at art. 17.4.1(a). A public service mandate is defined as "a government mandate pursuant to which a state-owned enterprise makes available a service, directly or indirectly, to the general public in its territory." *Id.* at art. 17.1. A service to the general public includes "the distribution of goods" and "the supply of general infrastructure service." *Id.* at art. 17.1. n.6.

123. *Id.* at art. 17.4.1(b)(i).

124. *See*, *e.g.*, *id.* at 17.6.1(a)-(c) ("No Party shall cause adverse effects to the interests of another Party through the use of non-commercial assistance . . . to any of its [SOEs] with respect to the production and sale of a good by the [SOEs]; the supply of a service by [SOEs] from the territory of the Party into the territory of another Party; or the supply of a service in the territory of another Party through an enterprise that is a covered investment in the territory of that other Party or any other Party.").

125. For instance, General Agreement on Trade in Services ("GATS") does not impose any restriction on subsidies to service suppliers. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183.

126. TPP, *supra* note 3, at art. 17.1; *see also id.* at n.4.

financing on terms more favorable than those commercially available to that enterprise; equity capital inconsistent with the usual investment practice of private investors; or provision of goods or services other than general infrastructure on terms more favorable than those commercially available to that enterprise.[127]

The second part's use of "adverse effect" refers to causing displacement from or impediment to the market due to the NCA.[128] There are several ways that complaining parties can show this has in fact happened. They can show that the market share of an NCA-receiving SOE: significantly increased; stayed constant when it should have decreased without the NCA; or fell at a significantly slower pace compared to the expected drop rate without the NCA.[129] Such cause of action, however, is not available against an NCA-receiving SOE with respect to services supplied by the SOE in its home market.[130]

"Injury," on the other hand, refers to "material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry."[131]

(4) Transparency

As a default matter, each Party has to provide a list of its SOEs.[132] Upon request, the Party must provide a demanding list of information. The list can be categorized as information required for the following: (1) proving the SOE status; (2) reviewing activities between SOEs and their government; (3) forming the basis of claims under the NCA provision.

The first category of information that must be disclosed upon request pertains to the various elements a complaining party must show to successfully allege that an entity is in fact an SOE. Such information includes: the percentage of cumulative shares held by the state, other SOEs, or "designated monopolies";[133] the percentage of votes they cumulatively have; any

127. *Id.* at art. 17.1.

128. *Id.* at art. 17.7.1.

129. *Id.* at art. 17.7.2.

130. The TPP puts emphasis on the exemption of a domestic supply of a service by making such exemption explicit in two different provisions. First, under Article 17.6.1, causing the adverse effects through the supply of a service by an SOE is barred only to the extent that it is supplied "from the territory of the Party into the territory of another Party." *Id.* at art. 17.6.1(b). Second, Article 17.6.4 reaffirms that a service "supplied by a state-owned enterprise of a Party within that Party's territory shall be deemed to not cause adverse effects." *Id.* at art. 17.6.4.

131. *Id.* at art. 17.8.1. The existence of material injury is determined "based on positive evidence and involve[s] an objective examination of the relevant factors, including the volume of production by the covered investment that has received non-commercial assistance, the effect of such production on prices for like goods produced and sold by the domestic industry, and the effect of such production on the domestic industry producing like goods." *Id.*

132. *Id.* at art. 17.10.1.

133. Designated monopoly refers to "a privately owned monopoly that is designated after the date of entry into force of [the TPP] and any government monopoly that a Party designates or has designated."

special shares or special voting rights; titles of any government officials serving as an officer or a board member; and annual revenue and total assets over the most recent three years.[134]

The second category covers information required to review activities between SOEs and the government. It includes facts regarding exemptions or immunities under the state's law that applies to the entity.[135]

The last category covers information required to form a basis of claims under the NCA obligation. Specifically, this would include a detailed explanation of any policies or programs for the provision of NCA, stating the form of NCA, the names of involved government agencies, any SOEs providing or receiving NCA, the amount of NCA, and any relevant legal basis and policy objectives underpinning the NCA.[136]

The rule has measures that purport to enforce transparency through dispute settlement.[137] More specifically, the rule requires that a relevant tribunal "draw adverse inference from instances of non-cooperation by a disputing party in [the] information gathering process."[138] It also stipulates that the tribunal "shall not request additional information to complete the record where the information would support a Party's position and the absence of that information is the result of that Party's non-cooperation in the information-gathering process."[139]

This procedural provision generally mirrors domestic investigation proceedings, including that of the United States. The relevant portion of the U.S. Tariff Act of 1930 states that if a party "has failed to cooperate by not acting to the best of its ability to comply with a request for information . . . the administrating authority . . . *may* use an inference that is adverse to the interest of that party."[140] The tone of the pertinent language is significantly less forceful than that of the TPP. Further, there is no rule that prevents the adjudicating body from giving a second chance to cure the prior noncompliance. In sum, the new transparency rule under the TPP sets in place an enforcement mechanism that goes even further than the most advanced FTAs or domestic procedures.

(5) Exemptions

Some types of entities that otherwise would fall within the definition of an SOE are either partially or entirely exempt from the obligations men-

Id. at art. 17.1. A government monopoly, in turn, is defined as "a monopoly that is owned, or controlled through ownership interests, by a Party or by another government monopoly." *Id.*

134. *Id.* at art. 17.10.3(a)–(d).
135. *Id.* at art. 17.10.3(e).
136. *Id.* at art. 17.10.4–5.
137. *Id.* at art. 28.
138. *Id.* at Annex 17-B. para. 9.
139. *Id.* at para. 11.
140. Tariff Act of 1930, 19 U.S.C. § 1667e(b) (2015) (emphasis added).

tioned above. For instance, sovereign wealth funds ("SWFs") are exempt from the obligations in the TPP, except for the NCA requirement.[141] SWFs are defined as enterprises that are "owned, or controlled through ownership interests" by a member state and satisfy the following two requirements:

> (a) serve[ ] solely as a special purpose investment fund or arrangement for asset management, investment, and related activities, using financial assets of a Party; and
> (b) [are] a Member of the International Forum of Sovereign Wealth Funds or endorses the *Generally Accepted Principles and Practices* ("Santiago Principles") issued by the International Working Group of Sovereign Wealth Funds, October 2008, or such other principles and practices as may be agreed to by the Parties . . . .[142]

Independent pension funds are almost entirely exempt from the obligations as well.[143] An independent pension fund refers to "an enterprise that is owned, or controlled through ownership interests, by a Party" and that is (1) exclusively engaged in "administering or providing a plan for pension, retirement, social security, disability, death or employee benefits, or any combination thereof solely for the benefit of natural persons who are contributors to such a plan and their beneficiaries," or "investing the assets of these plans"; (2) "has a fiduciary duty to the natural persons" as mentioned in (1) and; (3) "is free from investment direction from the government of the Party."[144] As with SWFs, however, a party may not provide NCA through, or to, enterprises owned or controlled by an independent pension fund.[145]

Some of the exceptions are confined to specific activities. For instance, the NCA requirement does not apply to an SOE-supplied service to the extent that the service is supplied in the SOE's home market.[146] Furthermore, temporary measures adopted to respond to national or global economic emergency are exempt from duties of non-discriminatory treatment, commercial consideration, and NCA.[147] SOE-supplied financial services mandated by the government are also exempt from both duties of non-discrimination and

141. TPP, *supra* note 3, at art. 17.2.5.
142. *Id.* at art. 17.1. For a more detailed explanation of SWFs and Santiago Principles, *see* Int'l Working Grp. of Sovereign Wealth Funds, *Sovereign Wealth Funds Generally Accepted Principles and Practices: "Santiago Principles,"* INT'L WORKING GRP. OF SOVEREIGN WEALTH FUNDS (Oct. 2008), http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf.
143. TPP, *supra* note 3, at art. 17.2.6.
144. *Id.* at art. 17.1.
145. *Id.* at art. 17.2.6.
146. *Id.* at art. 17.6.4.
147. *Id.* at art. 17.13.1(a).

commercial consideration as well as adverse effects under NCA if they support exports or imports.[148]

3. *Preliminary Analysis*

The TPP rule draws heavily from the existing rules under the GATT/WTO system when it comes to the substantive obligations for SOEs. Specifically, it largely mirrors the STE rule, subjecting SOEs to the requirements of commercial consideration and non-discrimination. To the extent that the STE rule was without a "bite" and saw only limited success in bringing about member states' compliance, the TPP rule's effect on a party's behavior may also appear to be limited.[149]

Nonetheless, it should be noted that there are several important changes accomplished in the new rule. First, as mentioned *supra*, the new rule creates a novel set of obligations, specifically by imposing a duty not to provide NCA to service providers.[150]

Second, they include enforcement mechanisms that provide better means to induce compliance. The key feature is that under the new rule, the court is allowed to draw an adverse inference from the non-compliance of the responding party. Unlike the pre-TPP system where the requesting parties had to rely largely on the grace and good faith of the responding party, the new rule sets in place procedural leverage that may often be determinative. The rule disallowing the court from giving a second notice or request to the noncomplying party before making such an inference further reinforces this potential pro-complainant tilt. In effect, noncompliance in the pre-dispute settlement stage could become fatal.

Third, the rule, as it reads, reverses the AB's interpretation of GATT Article XVII, which provides the substantive obligations of STEs. As mentioned *supra*, the jurisprudence at the WTO has long interpreted the duty of non-discriminatory treatment and the commercial considerations rule as illustrative of one another.[151] The relevant provisions in the GATT make clear the drafters' intent to establish such a relationship by defining them with reference to each other.[152] In contrast, the TPP puts them in two separate

148. *Id.* at art. 17.13.2(b)–3(a). Note that the exemption is a qualified one. The supply of such services must not be "intended to displace commercial financing," and must be "offered on terms no less favorable than those that could be obtained for comparable financial services in the commercial market." *Id.*

149. For an analysis on how the STE rule was left without a bite, see *supra* Part III.A.1.

150. These obligations are, as mentioned above, subject to several qualifications. For instance, a supply of a service is largely exempt from NCA requirement if the service is supplied in the domestic market. As will be elaborated *infra* at text accompanying note 173, the negotiation history suggests that this was at least in part to accommodate Japan's concern about Japan Post.

151. *See, e.g.*, Report of the Panel, *Canada—Administration of the Foreign Investment Review Act,* para. 5.16, L/5504 (Jul. 25, 1983), GATT BISD (30th Supp.), at 15; *see also* Panel Report, *Korea—Various Measures on Beef* at ¶ 757.

152. *See* GATT, *supra* note 47, at art. XVII(1)(a)-(b) ("[A] state enterprise . . . shall . . . act in a manner consistent with the general principles of nondiscriminatory treatment . . . [and the preceding

provisions with no logical link in between.[153] The literal reading of the TPP's text would therefore command that an SOE cumulatively satisfy both obligations in order to be in compliance with the rule.

IV. How Effective Will the Rule Be?

In this Part, the Note shifts attention to the factors that may potentially result in the TPP's inherent instability. In doing so, the Note juxtaposes the intended outcomes of the new rule with the reasons why these efforts could be undermined.

A. *Intended Effects of the Rule*

The new definition of SOEs intends to bring significant changes in practice. First, it extends the scope of the rules. As discussed *supra*, the pre-TPP rules that address SOE issues are largely anti-circumvention rules, intended to prevent states from circumventing their obligations simply by acting through an *alter ego*. These rules, therefore, require that the entity show certain characteristics that allow attribution of its conduct to that of a government. The key in many cases has been governmental authority. By instead defining SOEs in terms of state control or ownership of a quantifiable interest in a corporation, the new regime creates a new category of cases where state influence may be much more subtle, akin to that of a passive investor. This shift will bring commercial SOEs into the scope of the rule, despite their lack of the typical indicia of governmental authority.

Second, the rule helps private corporations that are exposed to relationships with SOEs make more informed business decisions. As discussed *supra*, the TPP clarifies the scope of the rule, giving guidance *ex ante* as to who qualifies as an SOE. The pre-TPP rules, in contrast, generally have either failed to provide a legal definition with a similar level of certainty or required consideration of multiple factors that are largely beyond the information-gathering capacity of an individual firm. These shortcomings in effect made it practically impossible for private-owned corporations to know with sufficient certainty the legal identity of their counterparties.

This threshold question about "who's who" may have significant relevance in several ways. First, it may affect the corporation's decision to enter certain markets in a foreign country. If the corporation realizes that a market has heavy state influence, its entry incentives may decrease. Second, it may affect the corporation's strategy in whether to start a business relationship with another corporation, and how to maintain it. Third, it may affect legal strategies that the corporation could consider at various levels, including

obligation] *shall be understood to* require that such enterprises shall . . . make any such purchases or sales solely in accordance with commercial considerations. . . .") (emphasis added).

153. *See*, *e.g.*, TPP, *supra* note 3, at art. 17.4.1.

when things go sour between the partners. The legal strategy issue is significant, especially for companies doing business in foreign countries, which have a great interest in maintaining a favorable relationship with the government. The new rule provides the corporations with the means to make business decisions with an informed basis as to whom they are dealing with.

Third, it brings down costs for the investigation authority of the complaining countries regarding illegal conduct involving SOEs. In both the STE and subsidies contexts, the rules have not provided efficient means to find that SOEs fall into the scope of the existing rules. In the subsidies context, for instance, the AB's recent rulings with respect to public bodies required an investigating authority to consider various factors, in addition to the significant control element. This requirement has forced authorities to carry out an extensive investigation of the entities involved, imposing a significant burden on the allocation of investigatory resources.[154] The situation has often been exacerbated in the face of the target countries' unwillingness to cooperate.[155] The new rule significantly simplifies the threshold matter of whether the rule applies to a certain entity, turning what used to be one of the most contentious matters into a factual question with a clear answer.

At the same time, the TPP rule heightens the cost of operating and maintaining SOEs, affecting the incentive structure for a government whose economy relies on SOEs to a certain extent. We have seen how the new clear definition of an SOE has breathed in a new life to the obligations. Once it is clear that a corporation is legally an SOE, the TPP regime subjects it to a set of obligations not applicable to a non-SOE. These obligations include a duty of non-discrimination, a duty to act consistently with commercial consideration, and a duty of disclosure of material facts, as discussed *supra*. These are obligations that private corporations do not have to assume, and are expected to raise the default cost of retaining and operating SOEs.

At least in theory, this change in the cost-benefit calculation would have an impact on the countries' predilection for the "visible hands." Due to the lack of progressivity in how the cost is structured to "phase out" proportionate to level of state ownership, the rule creates a "cost cliff," where the marginal cost of a state assuming an additional unit of ownership or control skyrockets at the 50% level. The AB's recent decisions regarding the public body issue reflect that it recognizes the importance of striking the right balance between possible circumvention by governments and abusive use of the countervailing measures by their trading partners.[156] The TPP rule tilts

154. *See, e.g.*, Issues and Decision Memorandum for Final Results of Countervailing Duty Administrative Review: Drawn Stainless Steel Sinks from the People's Republic of China, *supra* note 33, at 6.

155. *See, e.g.*, *id.* at 3, 6–7, 30, 32–33 (discussing the Chinese government's failure to supply necessary, requested data in a timely manner for the ITA's administrative review as constituting a failure to cooperate).

156. *See, e.g.*, Appellate Body Report, *US—Countervailing Measures (China)*; Appellate Body Report, *US—Carbon Steel (India)*. *See also* Ru Ding, *'Public Body' or Not: Chinese State-Owned Enterprise*, 48 J. World Trade 167, 175–76 (2014) ("As indicated in several WTO AB's decisions, and recognized in

that balance against SOEs, exposing them to a wider gamut of regulatory retaliation.

B. *Elements of Instability*

Despite the significant accomplishments of the new rule under the TPP and the rationale for the changes, however, the new rule suffers from several shortcomings.

1. *Lack of Consistent Legal Theory*

The most fundamental problem with the new rule is its lack of underlying legal doctrine. As discussed *supra*, the new rule avoids the fundamental but unsettled issue of labeling an entity as a state or as a corporation and instead bluntly creates the new legal concept of SOE that is neither a state nor a private corporation. This problem becomes apparent when we juxtapose the state-corporation binary: if the rule regards SOEs as private corporations, there is little justification for its systematic bias against SOEs, where it imposes obligations that private companies would not be subjected to. For instance, private-owned enterprises, by definition, are not subject to a duty of non-discrimination or a duty to respond to disclosure requests of foreign governments that the TPP imposes on SOEs.

On the other hand, if the rule was to redefine the boundary of state action, to address an undue state interference in the market, the boundary is both over- and under-inclusive at the same time. It does not capture the porous boundary between formal and informal state control, while penalizing an entity that acts without any state influence regardless of formal indication of ownership or control.[157] The rule merely describes and labels as problematic a contemporary phenomenon that it attempts to regulate, rather than defining the fundamental problem.

Does the lack of principled legal doctrine matter in practice? The lack of principle matters because the inherent conflict built into the rule leaves it vulnerable to unforeseen events or cases that require a judgment call. For instance, one of the elements to constitute an SOE is that an entity must "principally" engage in a commercial activity without defining when an entity becomes "principally" engaged in an activity.[158] When a close-call case comes along, an adjudicator might have to be in a position where they

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scholar's works, the goal of the [SCM Agreement] is to balance the discipline over both subsidies and countervailing measures. The government control approach potentially allows protectionism through imposing countervailing measures on products of all competing foreign SOEs or private companies if their products are provided by SOEs.").

157. *See, e.g.*, Milhaupt & Zheng, *supra* note 19 (arguing that in China, the state has less control over SOEs and more control over privately-owned enterprises than its ownership interest in such private firms would suggest).

158. TPP, *supra* note 3, at art. 17.1 ("[SOE] means an enterprise that is principally engaged in commercial activities.").

are forced to rely on the underlying rationale of the rule as opposed to what is written. If this situation arises, a rule without principled doctrine must resort to the adjudicator creating another bright line, or a temporary rule. This, in turn, will undermine the legitimacy and stability of the rule.

2. *Bright but Rigid Line*

Another set of issues with the rule has to do with the excessive rigidity of the line drawn to define SOEs. Admittedly, rigidity is a natural and foreseen consequence of adopting a bright-line, prophylactic rule. Further, there seem to be good reasons why the proponents of the rule would have opted for efficiency over flexibility. However, the criticism remains valid because the rigidity chosen is greater than necessary.

The excessive rigidity stems from two aspects of the definition. First, the rule puts in place just one dividing line, at 50%, and second, it creates a non-rebuttable presumption that the rules apply once the line is crossed.[159] However, there could have been ways to mitigate the rigidity by allocating different burdens of proof. One such possibility would have been to create a rebuttable presumption that the rules apply at a different level of shares or votes held by states. By segmenting the level of shares or votes owned by states, and allocating the burden of proof accordingly, the rule could have achieved the same, if not higher, level of efficiency and effectiveness with less rigidity. In fact, the U.S.-Singapore FTA provides a solid alternative:

> [W]here the government and its government enterprises, alone or in combination, own 50% or less, but more than 20%, of the voting securities of the entity and own the largest block of voting rights of such entity, there is [a] rebuttable presumption that effective influence exists.[160]

Such a flexible approach allows for restructured problems. Why is rigidity a problem, exactly? A rigid rule provides more incentives for the actors to restructure a problem rather than eliminate it. Combined with the cost cliff that comes with the line set at just one level, it is reasonable to anticipate that parties will find ways to reorganize their ownership or voting structure to circumvent the rule. For instance, some critics argue that there are already firms in which the government holds less than the majority of the voting rights, but still constitutes the largest block of voting rights.[161]

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159. *See supra* Part III.A.2.

160. U.S.-Singapore FTA, *supra* note 74, at art. 12.8.5(b).

161. Ben Hancock, *Reach Of TPP's SOE Disciplines Limited By Definition, Scope, Exceptions*, 33(43) Inside U.S. Trade, Nov. 6, 2015, at 23. ("An aide for the House Ways & Means Committee criticized this definition as creating a loophole for firms in which the government is heavily invested, but below the 50 percent ownership threshold, and where other shareholders individually have smaller stakes in the company than the government.").

For example, let us assume that Company A's largest shareholder is A Holdings, which with 30% of Company A's shares might be considered its controlling shareholder. The shares of A Holdings in turn are held by B (34%), C (17%), and D (49%). B and C are both SOEs.[162] The remaining 70% of Company A's shares are held by private investors. Let us also assume that each share entitles the shareholder one unit of voting rights and the power to appoint a majority of members of the board of directors. Is Company A an SOE? Let us further assume that Company A has maintained a long friendly relationship with Bank E, a commercial bank, the majority share of which is owned by a local government. Does this have any relevance to our analysis? What if we assume that the most influential director on Company A's board, X, is a former head of a large oil company with majority government-ownership?

Despite the many good reasons why we may think Company A is under significant control by its government, it probably "escapes" the TPP's SOE rule because it does not seem to qualify for any of the rule's requirements to be an SOE. Although the government is the controlling shareholder, it fails to "directly own[ ] more than 50 percent of the share capital."[163] Further, the government neither "controls, through ownership interests, the exercise of more than 50 percent of the voting rights" nor "holds the power to appoint a majority of members of the board of directors or any other equivalent management body."[164] Despite the likelihood that the long friendly relationships that Company A has established with state-owned commercial banks such as Bank E will further bring it within the influence of the government, the rule is blind to such factors.

The example above illustrates the fact that the rigidity of the rule would make it possible for SOEs to escape the rule with little effort.[165] It is important to note that this is not an implausible hypothesis. In fact, the ownership structure emulates the actual data of ZTE Corporation ("ZTE"), China's largest-listed telecommunications equipment company.[166] In this sense, the rigidity in effect renders the rule outdated as of the day it was devised.

Of course, it holds at least in theory that the WTO law provides a back-up rule for those that escape the rigid line drawn by the TPP. For instance, if a company with a minority ownership by the government functions as a

162. The data drawn and curated from the illustration of ZTE Corporation ("ZTE") provided in Milhaupt & Zheng, *supra* note 19, at 674.

163. TPP, *supra* note 3, at art. 17.1.

164. *Id.*

165. At the same time, the example may be used to illustrate the point raised in the previous part, that the seemingly bright-line rule would not necessarily resolve all the uncertainties. For instance, what does "any other equivalent management body" include? *See id*. Can a government hold a "power to appoint" a member of this body without any tangible proof of control such as the amount of shares? *See id.*

166. Company Overview, ZTE Corporation, http://www.zte.com.cn/global/about/corporate_information/Introduction.

pass-through of a government subsidy, the SCM Agreement will still apply to impose a countervailing duty as long as the adjudicatory body concludes that the entity "possess[ed], control[ed], or [was] vest[ed] with governmental authority."[167]

In practice, however, the WTO law is very unlikely to provide a meaningful supplement to the TPP's fast and easy cutoff rules. In fact, this brings us back to the reason why the new rule was called for in the first place. Today's SOEs, or enterprises that are at least partly owned by government, function just like their privately-owned competitors. The most recent cases analyzed *supra* show the AB's reluctance to attribute an entity's commercial activities to the government, unless the complainant shows that the government has vested its authority and the enterprise actually functioned with one.[168] The AB has constantly required more than a mere majority-ownership by the government—something to show that government authority was conferred to the entity, and the entity was in fact acting with one.[169] This mismatch in the WTO law allows a vast majority of enterprises with state-ownership to escape it. In fact, the 98% ownership by the Indian government was just not enough without other proofs of government authority.[170] *A fortiori*, an enterprise that looks and feels like a privately-owned corporation, but has less-than-majority ownership by government, such as ZTE, is even less likely to be "captured" by the WTO law.

3. *Loosely-Defined Carve-Outs: The Sausage-Making Gone Global*

The existence of a large number of carve-outs will further exacerbate the issue of parties restructuring the mode of state interference rather than eliminating it. Understandably, coming to an agreement among twelve parties was not an easy task, especially when many of them continue to rely heavily on SOEs. The tension between a push for a rule with "bite" and the reluctance from the East Asian parties resulted in a combination of a golden standard rule with exemptions that cover the parties almost entirely. Table 1 shows the positions taken by some of the parties who had strong views on SOE issues. Apparently, a significant portion of the carve-outs resulted from political compromises, not necessarily tailored to the issue that the rule tries to capture.

One example is a sweeping exemption for SOEs that a sub-central level government owns or controls.[171] This exemption reflects the reluctance of

167. Appellate Body Report, *US—Anti-Dumping and Countervailing Duties* at ¶ 317.

168. *See id.*

169. Appellate Body Report, *US—Carbon Steel (India)* at ¶ 4.52 ("[A] determination of whether a particular conduct is that of a public body 'must be made by evaluating the core features of the entity and its relationship to government' and 'must focus on evidence relevant to the question of whether the entity is vested with or exercises governmental authority.' The USDOC does not appear to have addressed these questions in its determinations.") (footnote omitted).

170. *Id.* at ¶ 4.55.

171. TPP, *supra* note 3, at Annex 17-D.

the United States to impose on itself the administrative burden to regulate local and municipal level SOEs. The exemption also will create incentives for countries to restructure their mode of ownership and control accordingly. The effectiveness of the rule will diminish proportionate to the overlap of interest between the central government and its sub-central counterparts.

Another example is an exemption for state-owned domestic service providers.[172] According to the available negotiation history, it seems that Japan strongly supported the "scale back" of the scope of the discipline, so that the rule does not regulate financial services in the domestic market. The most plausible explanation is that the scale back would exempt Japan Post from the rule.[173]

Another important exemption is the one given to sovereign wealth funds ("SWFs") for Singapore.[174] Negotiating history shows that Singapore and the United States both supported the exemption.[175] Although the rule contains the legal definition, its scope is arguably not as clear-cut compared with how SOEs are defined. Bearing in mind that many Asian countries are actively discussing the potential transformation of their SOEs into SWFs,[176] it is not particularly hard to imagine the SWFs of the next generation as being what SOEs are today.

There are other carve-outs that apply to specific parties, largely contained in the Annex of the TPP.[177] Although criticized for their arbitrary line drawing, the parties agreed to generally require that the names of the corporations to be exempted be annexed, so that the parties will have limited discretion to manipulate the scope of carve outs or create new ones.[178] Therefore, these carve-outs seem to have limited effect on the overall stability of the TPP rule. The exemptions and party-specific carve-outs are listed in the table below.

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172. *Id.* at art. 17.6.4.

173. Matthew Shewel, *U.S., Other TPP Countries Agree to Narrow Scope of SOE Chapter*, 32(9) Inside U.S. Trade, Feb. 28, 2014, at 2. Although some of the negotiators rejected this view by arguing that other "strong postal entity provisions elsewhere in the TPP" will in effect accomplish competitive neutrality between Japan Post and its competitors, this impliedly assures that the Post is beyond the scope of the SOE rules. *Id.* In parallel, Japan had arranged a bilateral deal with the U.S. competitor Aflac in 2013, allowing this Georgia-based company to offer cancer insurance products through its postal network. *Id.*

174. *See, e.g.*, TPP, *supra* note 3, at Annex 17-E.

175. *See, e.g.*, *U.S. Clarifies Treatment of Sovereign Wealth Fund Investment in TPP*, 30(37) Inside U.S. Trade, Sep. 21, 2012, at 1, 18–19.

176. *See, e.g.*, Yingyao Wang, *The Rise of the "Shareholding State": Financialization of Economic Management in China*, 13 Socio-Econ. Rev. 603, 615 (2015).

177. *See, e.g.*, TPP, *supra* note 3, at Annex IV.

178. *See, e.g.*, *id.*; *see also* Matthew Schewel, *Business Foresees Mixed Approach on Structuring SOE Exceptions in TPP*, 32(32) Inside U.S. Trade, Aug. 8, 2014, at 2.

TABLE 1

	Negotiation Priorities	Relevant Exemptions	Party-Specific Carve-Outs
United States	- Rules to apply only to central government SOEs	- Exemption for sub-central SOEs (Annex 17-D(i))	- Moderate carve-outs for various enterprises (Annex IV)
Singapore	- Broad carve-outs for SWFs without naming specific entities - Scale-back from U.S.-Singapore FTA commitment	- General exemptions for SWFs (Art. 17.2.5)	- Carve-outs for Singapore's SWFs (including Temasek Holdings (Private) Limited and GIC Private Limited.) (Annex 17-E) - Carve-outs for SOEs owned or controlled by SWFs
Malaysia	- Broad carve-out for Malaysian SOEs - Fervent opposition to SOE rule overall	- Exemption for sub-central SOEs (Annex 17-D(e))	- Higher threshold annual revenue (500 million SDRs instead of 200 million) - Carve-out for Permodalan Berhad, Lembaga Tabung Haji and their subsidiaries (Annex 17-F) - Sweeping carve-outs for various enterprises (Annex IV)
Vietnam	- Broad carve-out for Vietnamese SOEs - Fervent opposition to SOE rule overall	- Exemption for sub-central SOEs (Annex 17-D(j))	- Higher threshold annual revenue (500 million SDRs instead of 200 million) - Sweeping carve-outs for various enterprises (Annex IV)
Japan	- Scale-back on domestic service suppliers	- Exemption for sub-central SOEs (Annex 17-D(d) - Art. 17.6(4) general exemption for domestic service supplier	

V. CASE STUDY: APPLYING THE NEW RULE TO KOREA

A. *Korea: A "Natural" Partner for the TPP*

Korea first expressed its interest in joining the TPP in November 2013, but has since put emphasis on negotiations with China.[179] In doing so, it "has expressed its intention to cautiously study the implications of TPP membership."[180]

Less than two weeks after the conclusion of the TPP, however, President Park reiterated, rather subtly, Korea's interest in joining the Agreement:

179. Mireya Solís, *South Korea's Fateful Decision on the Trans-Pacific Partnership*, FOREIGN POL'Y AT BROOKINGS, Sep. 2013, at 1, 16 (2013).
180. *Id.*

> I would like to congratulate President Obama for the successful conclusion of TPP negotiations. Korea and the U.S. already have an FTA with very high standards. And in this respect, I believe that *we make natural partners in terms of the TPP.* Since TPP negotiations have now been concluded, *we will be engaging in closer cooperation with regard to Korea's possible participation in the TPP*.[181]

Since then, Korea has reaffirmed that it will "actively consider joining the TPP."[182]

As shown in Table 2 below, Korea's FTAs with 10 out of the 12 TPP founding members are in effect. Therefore, in terms of market access, the potential impact of signing on to the deal is expected to be minimal.[183] On the one hand, this could mean that the entry cost for Korea joining the TPP is much more limited than, say, when it signed the FTA with the United States several years ago.[184] On the other hand, the loss of market access by opting out of the TPP is estimated to be much more significant. The trade diversion effect, the argument goes, would result in Korea losing its competitive edge to a TPP member with similar industry structure, i.e. Japan.[185]

Put differently, Korea has few new reasons to be concerned about joining the TPP but has a lot to lose if it is left out. One of the new areas of concern is the novel rule on SOEs. It comes as no surprise, then, that the main domestic debates on whether to join the TPP or not are focused on interpretation and implications of Chapter 17.[186]

181. President Geun-hye Park, Rep. of Korea, Remarks in Joint Press Conference with President Barack Obama at the White House (Oct. 16, 2015) (emphasis added).

182. Kwanwoo Jun, *South Korea Reiterates Interest in Trans-Pacific Partnership*, Wall St. J., Oct. 5, 2015, http://www.wsj.com/articles/south-korea-reiterates-interest-in-trans-pacific-partnership-1444057143.

183. *See id.*

184. *See id.* ("Seoul has FTAs with 10 of the 12 TPP founding members, including the U.S., reducing the potential impact of signing on to the pan-regional deal.").

185. *See id.* ("[O]fficials in Seoul have expressed concerns about being outside the deal while Japan, which competes in many of the same export industries such as cars and electronics, benefits from reduced trade barriers."); Korea Trade-Inv. Promotion Agency [KOTRA], *TPP Hyeopsang Donghyanggwa Chamyeogukbyeol Jeollyak Mit Saneopgye Banuing* [*TPP Negotiation Trends, Member Country Strategy and Industry Reaction*], Global Market Report 14-045, at 38 (2014), http://125.131.31.47/Solars7DMME/004/14TPP 협상동향과참여국별전략및산업계반응.pdf.

186. *See, e.g.*, Jang Yeongeok, *TPP 'Gukyeonggieop Johang' . . . Gonggieop Eojjeona* [*TPP "SOE Provision" . . . What Will State-Owned Enterprise Do Now?*], Maeil Kyungjae, Nov. 8, 2015, http://news.mk.co.kr/newsRead.php?year=2015&no=1065193.

Table 2[187]

TPP-12 country	FTA Title	FTA Status
Australia	Korea-Australia FTA	In effect
Brunei	Korea-ASEAN FTA	In effect
Canada	Korea-Canada FTA	In effect
Chile	Korea-Chile FTA	In effect
Japan	Korea-China-Japan FTA	Under negotiation
Malaysia	Korea-ASEAN FTA	In effect
Mexico	Korea-Mexico FTA	Suspended
New Zealand	Korea-New Zealand FTA	In effect
Peru	Korea-Peru FTA	In effect
Singapore	Korea-Singapore FTA	In effect
United States	Korea-U.S. FTA	In effect
Vietnam	Korea-Vietnam FTA	In effect

B. *"Public Institutions" in Korea*

The SOE chapter has drawn a high level of domestic attention both because of the importance of public sector in Korea's economy and the novelty of the provisions therein. The biggest concern pertains to how sweeping the impact of the new rule will be in the context of Korea's economy and the critical role that its "public institutions" play in it.[188]

According to Korea's Act on the Management of Public Institutions,[189] public institutions are defined as:

> (1) an institution established by direct operation of another Act with an investment by the Government;
> (2) an organization that has government grants exceeding one-half of the amount of its total revenue;
> (3) an institution which the government holds at least 50% of the outstanding shares in or secures practical control over in making decisions on its policies through the exercise of the power to appoint executives with at least 30% of such outstanding shares or otherwise;
> (4) an institution which the government, together with other public institutions, holds at least 50% of the outstanding shares

187. *Free Trade Agreements*, Asia Reg'l Integration Ctr., https://aric.adb.org/fta-country (last visited Oct. 22, 2016).
188. Interview with Professor Dukgeun Ahn, *supra* note 4.
189. Gonggonggigwanui Unyeonge Gwanhan Beobyul [Act on the Mgmt. of Pub. Inst.], Act No. 8258, Jan. 19, 2007, amended by Act. No. 11845, May 28, 2013, Art. 4, para. 1, no. 1–6 (S. Kor.).

> in, or secures practical control over in making decisions on its policies through the exercise of the power to appoint executives with at least 30% of such outstanding shares or otherwise;
> (5) an institution which a single public institution or two or more public institutions hold at least 50% of the outstanding shares in, or secure practical control over, making decisions on its policies through the exercise of the power to appoint executives with at least thirty percent of such outstanding shares or otherwise; or
> (6) an institution established by an institution falling under any of subparagraphs 1 through 4 with an investment by the State or the establishing institution.[190]

Public institutions are further grouped into several sub-categories, depending on various factors including the number of employees and revenue amount. Table 3 below shows the different categories, as well as the number of public institutions in each category.[191] In the aggregate, there are more than 300 public institutions in Korea as of today at the central government level.[192]

190. *Id.*
191. Note that the table does not show public institutions affiliated with sub-central governments.
192. Press Release, Gihoekjaejeongbu [Ministry of Strategy and Fin.], 2016nyeondo Gonggong-gigwan Jijeongan Hwakjeong [Confirmation of Bill for 2016 Public Institution Designation] (Jan. 29, 2016), http://mosf.go.kr/nw/nes/detailNesDtaView.do?searchBbsId1=MOSFBBS_000000000028&searchNttId1=MOSF_000000000001762&menuNo=4010100.

Table 3

National Public Institutions	Public Corporation: 1. Self-generating revenue equal or more than 1/2 of total revenue 2. 50 or more employees 3. Minister designates	Market-based public corporations (14[193])	1. Asset size reaches or exceeds 2TR KRW[194] 2. Self-generating revenue/ total revenues reaches or exceeds 85%
		Quasi-market-based public corporations (16[195])	Public corporations other than the market-based public corporations
	Quasi-Public Institution: 1. 50 or more employees 2. Minister designates among non-public corporations	Fund-management-based quasi-governmental institutions (16[196])	Quasi-governmental institutions to which the management of a fund is assigned or commissioned under the National Finance Act
		Commissioned-service-based quasi-governmental institutions (74[197])	Quasi-governmental institutions other than the fund-management-based quasi-governmental institutions
	Non-classified Pubic Institution (203[198])		Public institutions not classified into either public corporations or quasi-governmental institutions

C. Korea's SOEs According to the TPP

Understandably, Korea's notion of public institutions does not perfectly overlap with that of SOE in the TPP. For instance, the category of "commissioned-service-based quasi-governmental institutions" includes a large number of government agencies that clearly do not fall within the scope of SOEs, such as Korea Occupational Safety and Health Agency ("KOSHA") and Korea Student Aid Foundation ("KOSAF").[199] Thus, I will first define the bounds of public institutions that potentially constitute SOEs and discuss the implications of the new SOE rule.

There are several factors that we can take into account in order to match the two distinct categories sufficiently close to each other. First, there are three sources of law that establish the public institutions: Article 32 of the

193. *Id.* at app. 1.
194. As of September, 2016, 2 trillion Korean Won is approximately $1.79 billion.
195. Gihoekjaejeongbu [Ministry of Stategy and Fin.], *supra* note 192.
196. *Id.*
197. *Id.*
198. *Id.*
199. *Id.* at app. 2.

Civil Act,[200] the Commercial Act,[201] and institution-specific laws.[202]The institutions established under the Commercial Act categorically share a list of characteristics with private corporations. For instance, they issue stocks and recognize corporate ownership based on the amount of shares held by each shareholder, just like any other private corporation.[203]

Another related factor is whether the entity takes the form of a corporation.[204] An entity that falls into this category would generally raise corporate funds by issuing stock, regardless of the type of governing law it falls under. The more private an entity's ownership structure is, the more likely that it engages in for-profit activities, potentially placing it within the scope of SOEs under the TPP.

As of 2015, there were sixty-one public institutions that met the two criteria mentioned above. Eight of these entities were public companies listed on domestic and/or foreign markets and at least seventeen of these entities were subsidiaries of other public institutions within this list. These institutions can be categorized into three sub-groups, based on their functions as well as the industries in which they operate.[205]

1. *Policy-Directed Lenders*

The first category that the new rule is likely to affect is Korea's policy lenders, such as the Korea Development Bank ("KDB"), The Export-Import Bank of Korea ("KEXIM"), and the Industrial Bank of Korea ("IBK"). Policy-directed lenders have historically played a defining role in Korea's rapid economic development.[206] Even today, these institutions continue to be considered a critical element of Korea's modern economy.[207] For this reason, Korea's policy-directed lending has invited scrutiny from other countries, notably the United States, which has repeatedly described the KDB as "one of the government's main sources of policy-directed lending to favored industries."[208]

Are these financial institutions considered SOEs under the TPP? According to official data, the Korean government is the majority shareholder of all

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200. Minbeob [Civil Act], Act No. 471, Feb. 22, 1958, *amended by* Act. No. 8720, Dec. 21, 2007, art. 32 (S. Kor.).

201. Sangbeob [Commercial Act], Act No. 1000, Jan. 10, 1962, *amended by* Act. No. 8582, Aug. 3, 2007 (S. Kor.).

202. Gihoekjaejeongbu & Hangukjosejaejeongyeonguwon [S. Kor. Ministry of Strategy and Fin. & S. Kor. Inst. of Pub. Fin.], 2015 Gonggonggigwan Hyeonhwangpyeonram [2015 Public Institution State of Affairs Handbook], http://www.kipf.re.kr/Publication/B/2015-%EA%B3%B5%EA%B3%B5%EA%B8%B0%EA%B4%80-%ED%98%84%ED%99%A9%ED%8E%B8%EB%9E%8C/523408.

203. *Id.* at 43. As of 2015, there were 30 institutions that are established under the Commercial Act, taking up 9.5% of the total public institutions. *Id.*

204. *See id.* at 44.

205. *See id.* at 45.

206. Interview with Professor Dukgeun Ahn, *supra* note 4.

207. *Id.*

208. USTR, National Estimate Report on Foreign Barriers of Trade (2015), https://ustr.gov/sites/default/files/2015%20NTE%20Combined.pdf.

of the three major lenders mentioned above.[209] The government directly owns 100% of KDB,[210] indirectly owns 100% of KEXIM (the government owns 70.1%, the Bank of Korea owns 15.0%, and the KDB owns the remaining 14.9%),[211] and owns a majority share of IBK (the government owns 50.4%, the KDB and KEXIM together own 11.1% and private institutions or investors own the remaining 38.5%).[212]

Thus, as far as the ownership structure goes, it is suggested that they fall within the definition. Therefore, whether they constitute SOEs would depend largely on how the principally-commercial-activities requirement is defined, as well as the size of their annual revenue derived from the commercial activities.

This is an important issue not only because of their significant roles in Korea's economy, but also because of the unique nature of their business. As a policy lender, they might step in as a majority shareholder to a troubled private corporation. For instance, KDB currently holds 50.75% of Daewoo Construction's shares through its Value Private Equity Fund.[213] Therefore, how the line is drawn will potentially bring the private subsidiaries of these institutions within the scope of SOE by virtue of majority ownership.

At the same time, the TPP rule allows several exemptions applicable to the service providers in general, as well as to the financial service providers. For instance, Article 17.6 stipulates that the NCA requirement would not apply to the services provided by these institutions to the extent that the services are supplied in their domestic market. Thus, domestic financial services that these lenders provide in the Korean market would be exempt from the NCA requirement.

Also, Article 17.13 allows for a sweeping exemption for the supply of financial services pursuant to a government mandate if they support exports or imports. KEXIM would probably fall safely within the definition and would be exempt from the NCA requirement, whether or not its services are provided domestically or abroad. The financial services provided by KDB and IBK in foreign markets, however, would probably not fall within the definition, since neither the services are mandated by the government nor does it support exports or imports. Thus, these services will be subject to the NCA requirement.

2. *Natural Resources & Energy*

The second category includes public institutions that are responsible for managing, extracting, and processing natural resources as well as providing

209. *See generally*, Gihoekjaejeongbu & Hangukjosejaejeongyeonguwon [S. Kor. Ministry of Strategy and Fin. & S. Kor. Inst. of Pub. Fin.], *supra* note 202.

210. *Id.* at 1415.

211. *Id.* at 139.

212. *Id.* at 1411.

213. Jang, *supra* note 186.

energy throughout the economy. A non-exhaustive list of the public institutions in this category includes Korea Gas Corporation ("Kogas"), Korea Electronic Power Corporation ("Kepco"), and Korea Water Resources Corporation ("K-Water").

According to official government data, all of the institutions mentioned above are majority-owned by the government. For instance, the government owns 54.6% of Kogas (the government owns 26.2%, Kepco owns 20.5%, and local government owns the remaining 7.9%),[214] 58.04% of Kepco (21.17% owned by government, 29.94% owned by the KDB, and 6.93% owned by National Pension Service, another public institution),[215] and 100% of K-Water (91.3% ownership by the government, remainder by the KDB).[216]

These institutions also hold majority shares of several subsidiaries. For instance, Kepco alone has ten subsidiaries, including Korea South-East Power Co. (100% owned by Kepco),[217] Korea Hydro & Nuclear Power Co., Ltd. (100% owned by Kepco),[218] and Kepco Plant Service & Engineering Co., Ltd. (52.48% owned by Kepco).[219] In turn, K-Water has one subsidiary called Water Way Plus, which is 100% owned by K-Water.[220]

Similar to policy-directed lenders, the proportion of for-profit activities as well as the revenue size must be considered in order to determine whether the SOE rule applies. Unlike the financial institutions, which typically supply services, institutions in this category seem to provide both services and goods, with varying degrees. For instance, Water Way Plus, a subsidiary of K-Water, almost exclusively supplies services such as holding events to educate and advertise the value of water and developing new tourist activities.[221] To the extent that the services are supplied domestically, institutions are exempt from some of the substantive obligations such as the NCA requirement. On the other hand, an institution like Kogas supplies mostly goods, in the form of natural gas and Liquefied Natural Gas ("LNG").[222] To that extent, the exemptions provided for services supplied domestically and for financial services supplied according to government mandate for import and export are not available. Other exemptions like SWF are even less applicable. Assuming none of the exemptions apply, all of the substantive obligations would attach.

214. Gihoekjaejeongbu & Hangukjosejaejeongyeonguwon [S. Kor. Ministry of Strategy and Fin. & S. Kor. Inst. of Pub. Fin.], *supra* note 202, at 723.

215. *Id.* at 753.

216. *Id.* at 1104.

217. *Id.* at 728.

218. *Id.* at 749.

219. *Id.* at 879.

220. *Id.* at 1140.

221. *Id.*

222. KOGAS Website, http://www.kogas.or.kr/en/what/business/system.action. (last visited Oct. 1, 2016) ("KOGAS is in charge of wholesale of natural gas in the domestic market. . . . KOGAS imports LNG and distributes it to consumers across the nation.")

3. *Transportation & Infrastructure*

The last category includes public institutions that provide public transportation services and infrastructure. A non-exhaustive list of the public institutions in this category covers Korea Railroad Corporation ("Korail"), Busan Port Authority ("BPA"), Incheon Port Authority ("IPA"), and Korea Land and Housing Corporation ("LH").

Again, the government is a majority shareholder in all of the institutions above. For instance, the government directly owns 100% of Korail,[223] BPA,[224] and IPA,[225] and indirectly owns 100% of LH (87.2% owned by the government, 12.0% by Korea Finance Corporation ("KoFC") now merged to KDB, and 0.8% by KEXIM).[226] Korail owns five subsidiaries, including KORAIL Tourism Development (60.8% owned by Korail and its subsidiaries),[227] Korail Networks (99% owned by Korail and its subsidiaries),[228] Korail Logis (97.3% owned by Korail and its subsidiaries),[229] and Korail Retail (100% owned by Korail).[230]

Because most of the institutions in this category provide services in the form of transportation, it is likely that some exceptions will be available even if they formally fall within the SOE definition. For instance, Article 17.6 will exempt domestic service providers from the NCA requirement.[231]

D. Policy Options for Korea

Bearing in mind that each party to the TPP was able to obtain a substantial amount of carve-outs to mitigate the potential domestic impact of the new rule, the Korean government must first engage in making the best case for a similar list. The Korean government must make a case that a significant number of public institutions that play a pivotal role in Korea's economy today will be affected. It also has to convince the other parties that they must leave room for flexibility for the rule to be sustainable and stable.

Not being a founding member, however, Korea is likely to be asked to pay some amount of latecomer-premium, which could take the form of unavailability of these carve-outs. There are several reasons why this is likely to be the case. First, the way NCMs were written in the Agreement suggests that parties intended to make it hard to make a new carve-out. For instance, the parties have agreed that the SOEs to be exempted from the obligations

223. Gihoekjaejeongbu & Hangukjosejaejeongyeonguwon [S. Kor. Ministry of Strategy and Fin. & S. Kor. Inst. of Pub. Fin.], *supra* note 202, at 1109.
224. *Id.* at 1183.
225. *Id.* at 1187.
226. *Id.* at 1114.
227. *Id.* at 1156.
228. *Id.* at 1160.
229. *Id.* at 1164.
230. *Id.* at 1168.
231. TPP, *supra* note 3, at art. 17.3.

must generally be specifically named in the Annexes.[232] Second, how the parties respond to Korea's requests will set an example for the other latecomers in the future. In effect, being a latecomer automatically puts Korea into the same category as the other potential latecomers that have a significant number of SOEs, including China. This precedent-setting will make the parties reluctant to give out exemptions for fear of needing to grant similar leeway to China and others.

Assuming that Korea will indeed pay a latecomer-premium in the form of limited exemptions, how significant would the effect of the new rule be? As mentioned *supra* Part III.B, the effectiveness of the TPP rule relies partially on raising the cost of maintaining SOEs by creating a "cost cliff." Taking into account the fact that Korea has been actively abiding by the pre-TPP rules, however, the actual effect of imposing a cost cliff will be less extreme. For instance, the ownership structures of Korea's public institutions are readily available online. Therefore, compared to other countries like China or India, which have frequently been criticized for their lack of transparency and non-responsiveness,[233] the actual additional cost for accepting the new rule is much less significant.

This does not mean that the new rule would not affect Korea at all. To minimize the unnecessary cost, I suggest three non-mutually exclusive options that the Korean government can further consider. First, Korea must fully assess the applicability of the various exemptions that are available to all parties. As mentioned *supra*,[234] this chapter provides several blanket exemptions for service providers that are relevant to Korea's potential SOEs.

Second, it must consider aligning its regulatory framework covering SOEs with the various lines that the TPP draws so that an institution will avoid double exposure to the rules in the TPP and the GATT/WTO. Currently, Korea's law governing public institutions fails to make a legal distinction between those that are principally engaged in commercial activities and those that are principally expected to carry out public functions on a non-profit basis. In fact, many of the institutions remain in the grey zone where they carry out a mixed set of purposes. As discussed *supra*, the additional layer introduced by the TPP means that any public institutions are categorically subject to either the TPP rule or the WTO rules; there is no grey zone. In effect, this means that the legal advantage of the "mixed-purpose model" will decrease. Thus, the policy makers must consider amending the governing law so that the institutions will fit it into either one or the other.

The last option to be considered in the long-term is to pursue further privatization. Korea has been constantly moving towards privatizing its SOEs and has already accomplished a significant level of privatization. For instance, several formerly state-owned entities such as Korea Telecom

232. *See, e.g.*, *id.* at Annex IV-A.
233. *See* text accompanying note 111.
234. *See supra* Parts IV.B.3 & V.C.

("KT") and POSCO had been fully and successfully privatized.[235] Today, the government is once again at a crossroads with respect to privatization of its public sectors. For instance, its plan to privatize some of its policy banks, including KDB and IBK, has recently been replaced with rollbacks.[236] With the new TPP rule in mind, Korea needs to reevaluate the cost-benefit calculation and consider the areas where privatization is possible and necessary.

VI. Conclusion

The TPP's new SOE rule is an understandable but an incomplete response to the rise of visible hands. It reflects both the qualitative transformation of the SOE issue in the context of international transactions and the frustration with the pre-existing rule. It intends to supplement the latter, mainly by introducing a bright-line definition of SOEs as well as updating the legal obligations to be attached. This prophylactic approach in effect breathes new life into the rules that could have regulated the SOEs, but had largely remained dormant for the past few decades. The rule is intended to enhance the enforceability and administrability of the legal framework. It is also structured to increase the cost associated with establishing and maintaining SOEs, affecting the parties' incentive structure to abide by their policy preference for SOEs.

There are several features inherent in the rule that are likely to affect its effectiveness in achieving its intended goal. First, the rule is vulnerable to future circumvention measures by the parties, mainly due to its lack of coherent doctrine, excessively rigid structure, and sweeping list of carve-outs and exemptions. If not managed carefully, these features will incentivize the parties to merely restructure the problem, while leaving the underlying issue of state intervention intact.

The weaknesses above, in combination with an ambitious rule, make it challenging for potential latecomers to accurately assess the ramifications of joining the TPP. Despite the fact that the rule might have a significant effect on how the entire society operates, the ambiguities of the rule make it hard for policy-makers to base any cost-benefit analysis on solid ground. The uncertainty regarding the latecomer-premium aggravates the challenge.

The rule's ramification on SOEs will not be limited to its current parties. The concerns identified in the Note will apply equally to other potential latecomers such as Korea. In Korea's case, the rule will likely affect "public

235. *See, e.g.*, Michael A. Witt, *South Korea: Plutocratic State-led Capitalism Reconfiguring*, (INSEAD Policy & Faculty Working Paper, 2012).

236. Kanga Kong, *Korea to Remerge Development Bank; May Sell Minority Stake*, Wall St. J., Aug. 27, 2013, http://www.wsj.com/articles/SB10001424127887323407104579038410087107236; *see also* Hyongki Park, *Ministry sells IBK shares for privatization*, Korea Herald (Nov. 27, 2013), http://www.koreaherald.com/view.php?ud=20131127000836; *see also* Hyunhee Park, *Korea Development Bank and Industrial Bank of Korea Will Again Be Public-Sector Banks, a Credit Positive*, Jan. 30, 2014, Moody's Investor Service.

institutions" within three categories: policy-directed lenders, natural resources and energy, as well as infrastructure and transportations. Considering the importance of these sectors, and the fact that many of the institutions in these categories are majority shareholders of other entities, including private conglomerates, the actual effect will not be negligible. These concerns also remain relevant for decision-makers of other potential latecomers such as Indonesia, Thailand, and the Philippines, as well as the negotiators for upcoming trade agreements such as TTIP and other FTAs. They must take into account the framework proposed in this Note with respect to the estimated cost of the new SOE rule and how to best minimize the cost.