Review of joint ventures under the new EC Merger Regulation

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The new EC Merger Regulation (ECMR) 139/2004 (2004 OJ L 24/1) was enacted on 20 January 2004 and came into force as of 1 May 2004, in conjunction with the enlargement of the EU to 25 Member States. At the same time, the European Commission adopted a new implementing regulation (802/2004–2004 OJ L 133/1) and earlier in the year amended its guidelines on the assessment of horizontal mergers under the ECMR (2004 OJ C 31/5) ('the Horizontal Merger Guidelines').

At first glance, it appears little will change. The jurisdictional thresholds remain the same. After much debate, the Commission rejected the adoption of the Anglo-Saxon 'substantial lessening of competition' (SLC) standard in favour of the 'significant impediment to effective competition', or SIEC, standard, which incorporates the previous European 'dominance' standard. The Commission opted not to bring so-called 'partial function' joint ventures within the scope of the Merger Regulation, leaving intact the limitation on jurisdiction to 'full function' joint ventures. A closer look, however, reveals that the changes are quite radical. Jurisdiction will be significantly affected, both as a result of enlargement and as a result of the expanded scope for referrals (in both directions) between the Commission and Member State competition authorities. Although the new Merger Regulation retains the term 'dominance', as the chairman of the OFT has pointed out, like Humpty Dumpty, the Commission has re-cast the term to mean what it chooses the term to mean, to include both the existing dominance standard and SLC ('When I make a word do a lot of work like that, said Humpty Dumpty, I always pay it extra.' Lewis Carroll, *Through the Looking Glass*, chapter 6.)

Joint ventures remain the problem child of European competition laws. Chameleon-like, they often combine elements of concentrations, on the one hand, and of cooperation between competitors on the other. They do not fit neatly within legal frameworks which tend to view the world in terms of absolutes (eg, 'Has a dominant position been created?' 'Does the agreement restrict competition?' 'Are the criteria for exemption satisfied?'). At the EC level, this has led to a plethora of somewhat artificial distinctions in attempting to fit joint ventures within the existing framework of EC competition law, the significance of which has changed with each adaptation of the ECMR and the European Commission's practice thereunder. At the same time, the conceptual difficulties of the EC have seeped into Member State laws, both because the application of the Commission's nomenclature affects who has jurisdiction, and because the competition laws of most Member States borrow from the EC model to varying degrees.

As a result, parties to a joint venture must contend with a range of potentially applicable competition rules, including the ECMR, Member State merger control laws, Article 81 of the EC Treaty and/or analogous provisions under Member State antitrust laws. Hence, determining whether a joint venture is subject to mandatory—or even voluntary—notification to one or more European competition authority(ies) is often complex.

Jurisdiction to review joint ventures under the ECMR

Joint ventures that fall under the ECMR must be notified to the Commission, prior to the implementation of the agreement. A joint venture that has been cleared under the ECMR is, for all intents and purposes, immune from challenge under Member State competition laws. The first step in any determination of if and to which authority to notify a joint venture is therefore to determine the applicability of the ECMR.

To fall within the jurisdiction of the ECMR, three criteria must be satisfied:

1. The joint venture results in two or more entities sharing 'joint control';
2. The parties' aggregate and individual turnovers exceed the ECMR thresholds; and
3. The joint venture is 'full function'.

We discuss each of these criteria below.

Joint control

For a joint venture to qualify as a concentration under the ECMR, it must result in two or more entities (that are not part of the same corporate group) sharing 'joint control' over another entity. This may take the form either of one company taking a stake in an existing company owned by another company, or of the creation of an entirely new company. Either way, it is important to keep in mind that the concept of 'control' does not necessarily conform to notions of control under corporate or securities law. It is not necessary for two or more parties to have even 50 per cent of the voting capital of the joint venture company. It will suffice that two or more parties have significant blocking rights—actual or de facto veto rights—over certain key decisions that go beyond ordinary minority shareholder rights and which effectively allow them to 'exercise a decisive influence' over the joint venture company. Such rights may include the ability to block the adoption of the business plan, significant capital expenditures, and/or senior management appointments.

Turnover thresholds

The new Merger Regulation leaves in place the existing turnover thresholds. Even if the control test is satisfied, a joint venture will only fall within the ECMR if the parties' combined and individual turnovers meet one of two tests (for the purpose of determining whether the jurisdictional thresholds have been met, a party's turnover is for the last full financial year and includes the aggregate turnover of the entire corporate group, including companies in which the parent directly or indirectly holds more than

half of the assets, capital, voting rights or board appointments, adjusted for acquisitions and divestitures subsequent to the end of the financial year).

The primary jurisdictional test set out in Article 1(2) gives the Commission jurisdiction to review a concentration if in the most recent financial year (adjusting for acquisitions and divestitures):

- the combined worldwide turnover of all parties involved exceeded €5 billion; and
- at least two parties individually had turnover within the European Community in excess of €250 million;
- unless each party to the concentration generated at least 2/3 of its aggregate Community-wide turnover in one and the same EC Member State.

The secondary test, set out in Article 1(3), was introduced in 1998 to catch smaller transactions that were nonetheless likely to require a filing in multiple Member States. Under this test, the Commission has jurisdiction to review a concentration if:

- the combined worldwide turnover of all parties involved exceeded €2.5 billion; and
- at least two parties individually had turnover within the European Community in excess of €100 million; and
- the combined turnover of all parties involved exceeded €100 million within each of three EC Member States; and
- within the same three EC Member States, the individual turnover of each of at least two parties exceeded €25 million;
- unless each party to the concentration generated at least 2/3 of its aggregate Community-wide turnover in one and the same EC Member State.

Although the new ECMR does not change the jurisdictional thresholds, the accession of an additional 10 Member States in May 2004 will make it easier to fall within the scope of the ECMR by increasing the pool of revenues used to satisfy the Community-wide and Member State turnover thresholds.

The new ECMR also substantially increases the scope for the Commission to refer joint ventures to Member State competition authorities ('MSCAs'). Under the old Article 9, which governed referrals from the Commission to MSCAs, an MSCA that sought referral was required to show that the notified concentration 'threatens to create or strengthen a dominant position' on a market within the Member State. As explained in more detail below, joint ventures are assessed both with respect to whether they create or strengthen a dominant position, as well as with respect to whether they will lead to the coordination of the competitive behaviour among independent undertakings (so-called 'spill-over' effects to which Article 81 would apply). In principle, at least, old Article 9 did not permit MSCAs to request referral to investigate spill-over effects (although the issue was never decided, in at least one case a Member State authority sought to circumvent this limitation by arguing that a joint venture would strengthen its parents' position of collective dominance in a downstream market). The new version of Article 9 removes this limitation by allowing referrals to MSCAs where a concentration 'threatens to affect significantly… [or]… affects competition' in a market within a single Member State.

Full functionality

Even though a joint venture may give rise to the acquisition of joint control and satisfy the turnover tests, it will not fall within the ECMR unless it is a 'full function' joint venture. Although in some cases this determination is straightforward, in others it is not, in part because the Commission's published notices and past decisions do not fully reflect the evolution of its actual practice.

'Concentrative' and 'cooperative' joint ventures

Prior to 1998, the ECMR excluded from its jurisdiction any full function joint ventures that would 'give rise to coordination of the competitive behaviour of the parties amongst themselves or between them and the joint venture'. This provision was intended to restrict the Commission's analysis to the competitive effects of capital concentrations (ie, to exclude cases that also raised issues of potential collusion). Parties frequently engaged in lengthy debates with DG Comp over whether a particular joint venture was 'concentrative' (ie, within the ECMR), or 'cooperative' (ie, outside the ECMR). This distinction was officially eliminated by the 1998 amendments, by allowing the Commission to review the 'cooperative' aspects of full function joint ventures as well as their 'concentrative' aspects; however, the terms (with all their baggage) have survived their repeal in some corners of both the practising community and DG Comp.

Indeed, the merger control provisions of the Dutch and Spanish competition laws retain the pre-1998 reference to coordination of competitive behaviour. This potentially leaves room for parties to challenge the referral of a joint venture to either Member State on the grounds that their competition laws are not capable of reviewing full function but cooperative joint ventures. However, the scope of ECMR Article 9 is probably broad enough to allow those authorities to review the joint ventures under EC Treaty Article 81 or its analogues, subject to the time limits imposed by ECMR Article 10.

The term 'full function joint venture' refers to a joint venture that satisfies the criteria of Article 3(4) of the ECMR, which reads: 'The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration within the meaning of paragraph 1 (b).'

The Commission has explained in its 'Notice on the concept of full-function joint ventures' ('the FFJV Notice') that to be 'full function' and thus satisfy Article 3(4) of the ECMR, the joint venture must:

- operate on a market, performing the functions normally carried out by undertakings operating on the same market;
- have a management dedicated to its day-to-day operations and access to sufficient resources including finance, staff, and assets in order to conduct on a lasting basis its business activities within the area provided for in the joint venture agreement;
- not merely take over one specific function within the parent companies' business activities without access to the market; and
- be intended to operate on a lasting basis (generally interpreted as either an indefinite duration or for an initial period of five years with the possibility of renewal).

It is not necessary for a joint venture to be full function at start-up, provided that it will become full function in a reasonably short period of time. For example, in the its decision in Case M.2763, *Toray/Murata/Teijin*, the Commission accepted as full function a joint venture that would initially only perform joint marketing services and would only acquire manufacturing assets one year after formation.

An important caveat arises where the parents of the joint venture will be either a supplier to or a customer of the joint venture.

The FFJV Notice states: "The strong presence of the parent companies in upstream or downstream markets is a factor to be taken into consideration in assessing the full-function character of a joint venture where this presence leads to substantial sales or purchases between the parent companies and the joint venture." The FFJV Notice goes on to explain that, notwithstanding the existence of long-term sales between joint venture and the parents, "the essential question is whether, regardless of these sales, the joint venture is geared to play an active role on the market".

Although Commission decisions frequently take into account the share of sales between the joint venture and its parents in reported decisions, it has never found that a joint venture was not full function solely on the grounds of the share of a joint venture's sales accounted for by its parents. However, in the context of pre-notification meetings held in accordance with the so-called 'Best Practices' guidelines (which have also been significantly amended as part of the new ECMR package), the Commission commonly advises parties not to file a notification in borderline cases, in order to avoid taking a formal decision. As a result, there is a gap between the standards set out in reported decisions and other published guidance and the Commission's actual and evolving policy. Nonetheless the Commission's recent decision in Case No. COMP/M.3101, *Accor/Hilton/Six Continents JV* may provide some useful guidance. There, the Commission accepted that a joint venture that would provide Internet distribution to its parents was full function because the joint venture's success would depend on the extent to which third parties that signed up for its services.

Full-functionality is likely to be an issue in the case of outsourcing, B2B and other innovative means of 'marketising' back office and other business functions that would traditionally have been provided internally. One potential problem is that questions may arise whether there is in fact a 'market' for the goods or services provided by the joint venture. Particularly where there is only a small number of potential buyers for a particular good or service, DG Comp has been known to express doubts about whether a market as such exists on which the joint venture can act, even though there may be third-party customers for its services (this view is somewhat at odds with the position taken in the Commission's 'Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation' (the 'Horizontal Guidelines'), at note 41, that '[a] production joint venture which also carries out joint distribution is, however, in most of the cases a full-function joint venture').

Another issue with far-reaching implications for outsourcing and B2B joint ventures is whether the joint venture's customers are likely to take equity stakes. The authors are aware of at least one instance involving a joint venture that would provide a common input to its parents, where the Commission advised the parents not to file, because—although the joint venture would have its own management and staff, be financially independent of its parents, and would actively sell to third parties—third parties would be likely to seek to acquire equity stakes in the joint venture.

In the absence of case law guidance, parties to joint ventures that satisfy the ECMR control and turnover criteria, but involve

Joint dominance and spill-over: convergence

In an attempt to deal with the problem of oligopolistic (ie, highly concentrated) markets, the Commission introduced the concept of 'collective dominance' (also referred to as 'joint dominance'), under which multiple firms are considered collectively to occupy a dominant position. With Court of First Instance's decision in Airtours, *collective dominance became synonymous with tacit collusion, ie a situation in which the market structure causes firms to reach a 'consensus' on price and output rather than to compete—in other words, to 'coordinate their competitive behaviour'. As the Commission's economic analysis became more sophisticated, its joint dominance analysis under Articles 2(3) and its spill-over analysis under 2(4) converged. (cf Case No. IV/JV.22,* Fujitsu/Siemens *(old Article 2(4) analysis) and Case No. Comp/M.2498,* UPM-Kymmene/Haindl *(old Article 2(3) analysis)). The Commission's current approach to analysing the likelihood of tacit collusion is set out in detail at paragraphs 39-60 of the Horizontal Merger Notice.*

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concentrated markets or innovative products or services, have little choice but to seek the view of DG Comp before deciding whether or not an EC merger filing is required.

Standard of review

The ECMR subjects full function joint ventures to a two-part test. The first part of the test, to which all concentrations are subject, is set out in Article 2(3): will the concentration significantly impede competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position? New Article 2(3) is substantially unchanged from old Article 2(3), with the creation or strengthening of a dominant position being one element of the SIEC test.

The second part of the test, which only applies to full function joint ventures, is set out in Article 2(4): does the joint venture have as its object or effect the coordination of the competitive behaviour of undertakings that remain independent? If so, such 'spill-over' effects are subject to review to determine whether the joint venture will be caught by the prohibition against restrictive agreements under Article 81(1) of the EC Treaty, and, if necessary, whether the joint venture would generate efficiencies and/or promote technical progress and benefit consumers in a way that would allow the agreement to be exempted under Article 81(3).[1]

The new SIEC test also governs the risk of coordinated effects arising from a concentration, ie the risk that as a result of the concentration companies would find it easier to engage in tacit or actual collusion. It is clear that the Commission's economic analysis of joint dominance and spill-over has already converged (see box). Thus, the only practical difference between the two provisions is that in reviewing spill-over effects under Article 2(4), the Commission applies the formal criteria of Article 81(1) and (3). With the introduction of Regulation 1/2003, which makes Article 81(3) directly applicable and removes the time limit on exemptions required under Article 8 of the old Regulation 17/62, there is no substantive difference between clearance under Article 2(3) and exemption under Article 2(4). At the time of writing, there have only been two published cases involving full function joint ventures under the new ECMR (Case No. COMP/M.3467, *Dow Chemicals/PIC/White Sands JV*; Case No. COMP/M.3422, *BBVA/BNL/JV*) and these have not raised any issues.

Notes

1 Previously, such Article 81(3) exemption would have required a notification on Form A/B to the European Commission. However, since the abolition as of 1 May 2004 of the notification regime pursuant to Regulation 1/2003 (2003 OJ L 1/1), the parties must undertake a self-assessment (according to the criteria set forth in the European Commission's Guidelines on the application of Article 81(3) (2004 OJ C 101/97)) to determine whether the arrangements would satisfy the conditions of Article 81(3).