Freshfields Bruckhaus Deringer

Disguised Cartels

Joint Ventures between competitors under EU Competition Law

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Overview

Cooperation in the form of Joint Ventures (**JVs)**

- EU approach to JVs
- JVs as a tool to engage in a “disguised cartel”
- Self-assessment
- General principles
- Production
- Commercialisation
- R&D
- Purchasing
- Information exchange

Spill-over effects of JVs

- Application of Article 101 under the EUMR

Cooperation in the form of JVs

Diversity of arrangements which can be described as JVs - complex analysis

- **JVs vs. other looser horizontal cooperation agreements** - difference in terms of **legal structure** and **management**

- JVs often combine both structural change (typically the setting up of a jointly-owned company or acquisition of shares in a pre-existing company) and elements of a cooperation agreement

EU approach to JVs

"There is often only a fine line between full-function joint ventures that fall under the Merger Regulation and non-full-function joint ventures that are assessed under Article 101. Hence, their effects can be quite similar" (EC Horizontal Guidelines 2011)

- **Full-function JVs**
  - JVs which perform all the functions of an autonomous economic entity on a lasting basis
  - Subject to review under the EUMR
- **Co-operative JVs**
  - JVs which do not perform all functions of an autonomous entity (e.g. only R&D and/or production but not sales and marketing)
  - Subject to review under Article 101 TFEU
- **Mixture of the two**
  - A full-function JV with cooperative aspects
  - subject to two tests within the EU merger control review:
    - under the EUMR: concentrative aspects
    - under Article 101 TFEU: coordination aspects ("spill-over" effects)

Non-full function JV as a tool to engage in a "disguised cartel"

Cooperative JVs are a common form of collaboration between competitors which may produce significant pro-competitive effects without infringing the EU competition rules

- For example, where the parents do not have the resources to undertake the JV activity independently
- However, JVs could also serve as a tool to engage in a "disguised cartel" - parents may use the structure of a JV in order to:
  - Fix prices
  - Limit output
  - Allocate markets/customers
  - Exchange commercially sensitive information beyond what is required for the functioning of the JV
  - Foreclose access to an input/output market

JVs: self-assessment

Self-assessment of application of Article 101 TFEU

- Does the JVs restrict competition in the sense of Article 101(1) TFEU?
- Does the JV fulfil the conditions of a Block Exemption Regulation (BER)?
  - R&D BER
  - Specialisation BER
- Does it fulfil the conditions of Article 101(3) TFEU?
  - The Commission has issued guidelines on how it will assess horizontal cooperation agreements falling outside BERs (*Horizontal Guidelines 2011*)

JVs: general principles of assessment

Likely to restrict competition?

- JVs that involve jointly determining prices, volumes/output, or allocating markets or customers restrict competition by object
- Other types of JVs may lessen competition depending on a number of factors:
  - the nature of the cooperation
  - the market position of the parties (e.g. high market shares)
  - how difficult it is for new competitors to enter the market
  - particular market dynamics
  - the proposed duration of the JV

Justifiable due to efficiencies?

- Even if JVs restrict competition, they can still be justified under Article 101 (3) TFEU:
  - must give rise to **efficiency gains** (e.g. lower prices, increased output or higher quality products or services)
  - must be **indispensable** to producing those gains, and there must be **no less restrictive way** of achieving those gains
  - consumers must receive a **fair share** of the benefits, and
  - must not eliminate competition in respect of a **substantial part** of the market in question

Research and development JVs

Research & development JVs

Definition

- Research & development (**R&D**) JVs may vary in form and scope ranging from outsourcing certain R&D activities to the joint improvement of existing technologies and to a cooperation concerning the research, development and marketing of completely new products

Market power / "safe harbour"

- R&D JVs are only likely to give rise to restrictive effects on competition where the parties to the co-operation have market power on the existing markets and/or competition with respect to innovation is appreciably reduced
- R&D agreements between competitors are subject to exemption provided that their combined market share does not exceed 25% and that the other conditions for the application of the R&D Block Exemption Regulation are fulfilled
- R&D cooperation concerning entirely new products is unlikely to give rise to restrictive effects on competition unless only a limited number of credible alternative R&D poles exist

Competition risks

- Reduction of innovation, leading to fewer or worse products coming to the market later that they otherwise would
- Reduction of competition between the parties outside the scope of the agreement
- Anti-competitive coordination
- Foreclosure – for example, where one of the JV's parents has a significant degree of market power for a key technology and the exclusive exploitation of the results

Example of R&D JV

Situation

- A and B are the two major companies on the EU market for the manufacture of existing electronic components. Both have a market share of 30%.
- A and B have each made significant investments in the R&D necessary to develop miniaturised electronic components and have developed early prototypes. A and B now agree to pool these R&D efforts by setting up a JV to complete the R&D and produce the components, which will be sold back to the parents, who will commercialise them separately.
- The remainder of the market consists of small companies without sufficient resources to undertake the necessary investments.

Competitive analysis

- If the JV goes ahead then only one route to the necessary manufacturing technology will exist, whereas it would appear likely that A and B could reach the market individually with separate products
- The JV is also likely to directly limit competition between the parties and lead them to agree on output levels, quality or other competitively important parameters
- The market is likely to develop into a duopoly with a high degree of commonality of costs and possible exchange of commercially sensitive information
- While the JV could give rise to efficiency gains in the form of bringing a new technology forward quicker, the parties would on the other hand face no competition at the R&D level, so their incentives to pursue the new technology at a high pace could be severely reduced
- The JV likely to give rise to restrictive effects

(EC Horizontal Guidelines 2011)

Production JVs

Analysis of production JVs

Definition

- Companies can produce jointly by way of a JV, i.e., a jointly controlled company operating one or several production facilities

Analysis of market power / "safe harbour"

- If combined market does not exceed 20% in the relevant market(s) and if the other conditions are fulfilled → application of the Specialisation BER
- Generally a concentrated market more likely to lead to restrictive effects on competition
- Even if the market shares of the parties and the market concentration are high, the risks of restrictive effects on competition may still be low if the market is dynamic, i.e., a market with entry and market positions changing frequently.

Competition risks

- A direct limitation of competition between the parents (e.g. price-fixing, limiting output, sharing markets or customers)
- Exchange of commercially sensitive information and/or increased commonality of costs may lead to anti-competitive coordination
- Foreclosure of third parties in a related market (e.g. parties engaging in a joint production on an upstream market may be able to raise the price of a key component for a market downstream)

Example of a production JV

Situation

- A and B set up a production JV for the intermediate product X which covers their entire production of X
- The production costs of X account for 70% of the variable costs of the final product Y with which A and B compete downstream
- A and B each have a share of 20% on the market for Y, there is limited entry and the market shares have been stable over time
- Both A and B each have a market share of 40% on the merchant market for X
- There are high barriers to entry on the market for X and existing producers are operating near full capacity
- On the market for Y, there are two other significant suppliers, each with a 15% market share, and several smaller competitors

Competitive analysis

- By virtue of the production JV, A and B would be able to largely control supplies of the essential input X to their competitors in the market for Y. This would give A and B the ability to raise their rivals' costs by artificially increasing the price of X, or by reducing the output
- Economies of scale unlikely to outweigh the restrictive effects on competition
- JV likely to give rise to anti-competitive effects due to the potential anticompetitive foreclosure downstream

(EC Horizontal Guidelines 2011)

Commercialisation JVs

Analysis of commercialisation JVs

Definition

- Commercialisation JVs may involve co-operation between competitors in the selling, distribution or promotion of their substitute products. This type of JVs can have a widely varying scope, depending on the marketing functions which are being covered by the co-operation

Analysis of market power / “safe harbour”

- In most cases, it is unlikely that market power exists if the parties have a combined market share not exceeding 15%

Competition risks

- Price fixing - joint selling agreements generally have the object of coordinating the pricing policy of the parents
- Output limitation - parties may decide on the volume of products to be put on the market, therefore restricting supply
- Sharing of markets/customers - where the parties’ production plants are located in different geographic markets or the agreements are reciprocal
- Exchange of commercially sensitive information - relating to aspects within or outside the scope of the JV or to commonality of costs which may result in a collusive outcome

Example: joint commercialisation necessary to enter a market

Situation

- Four companies providing laundry services, each with a 3% market share of the overall laundry market in one city, agree to create a joint marketing arm for the selling of laundry service to institutional customers (i.e., hotels, hospitals, offices), whilst keeping their independence and freedom to compete for local, individual clients
- In view of the new segment of demand (the institutional customers) they develop a common brand name, a common price and common standard terms including, inter alia, a maximum 24h time-length before deliveries and schedules for delivery
- In order to ensure the viability of the project, it is indispensable that all four of them enter into the agreement
- The market is very fragmented, with no individual competitor having more than 15% market share.

Competitive assessment

- Although the joint market share of the parties is below 15%, the fact that the agreement involves price fixing means that Article 101(1) could apply
- However, the parties would not have been in a position to enter the market of providing laundry services to institutional customers, either individually or in cooperation with a fewer number of parties than the four currently taking part in the agreement
- The price-fixing restriction is indispensable to the promotion of the common brand and the success of the project

(EC Horizontal Guidelines 2011)

Purchasing JVs

Analysis of purchasing JVs

Definition

- Purchasing JVs concern the joint purchase of products by the parent companies via the JV. Two markets may be affected:
  - the market(s) with which the JV is directly concerned, i.e., the relevant purchasing market(s) upstream
  - the selling market(s), i.e., the market(s) downstream where the parties are active as sellers

Analysis of market power / "safe harbour"

- Unlikely that market power exists if the parties have combined market share not exceeding 15% on the purchasing market(s) as well as a combined market share not exceeding 15% on the selling market(s)
- Anticompetitive buying power is likely to arise if the purchasing JV accounts for a sufficiently large proportion of the total volume of a purchasing market
- Generally, purchasing JVs are less likely to give rise to competition concerns when the parties do not have market power on the selling market(s)

Competition risks

- A restriction of competition by object if the JV serves as a tool to engage in price fixing, output limitation or market allocation
- To foreclose competing purchasers by limiting their access to efficient suppliers – only possible if there are a limited number of suppliers and there are barriers to entry on the supply side of the upstream market
- A risk that the JV parents may force suppliers to reduce the range or quality of products they produce
- Incentives of sellers for price competition on the selling market(s) may be considerably reduce

Example of purchasing JV

Situation

- Two supermarket chains set up a JV to jointly purchase products which account for roughly 80% of their variable costs.
- On the relevant purchasing markets for the different categories of products the parties have combined market shares between 25% and 40%. On the relevant selling market they have a combined market share of 60%.
- There are four other significant retailers each with a 10% market share.
- Market entry is not likely.

Competitive analysis

- It is likely that the JV would give the parties the ability to coordinate their behaviour on the selling market, thereby leading to a collusive outcome. The parties have market power on the selling market and the JV gives rise to a significant commonality of costs. Moreover, market entry is unlikely
- The JV also creates the risk that by the parties‘ withholding demand and, consequently, as a result of reduced quantity, downstream selling prices would increase.
- Efficiency gains unlikely to be passed on to consumers
- JV likely to give rise to restrictive effects on competition

(EC Horizontal Guidelines 2011)

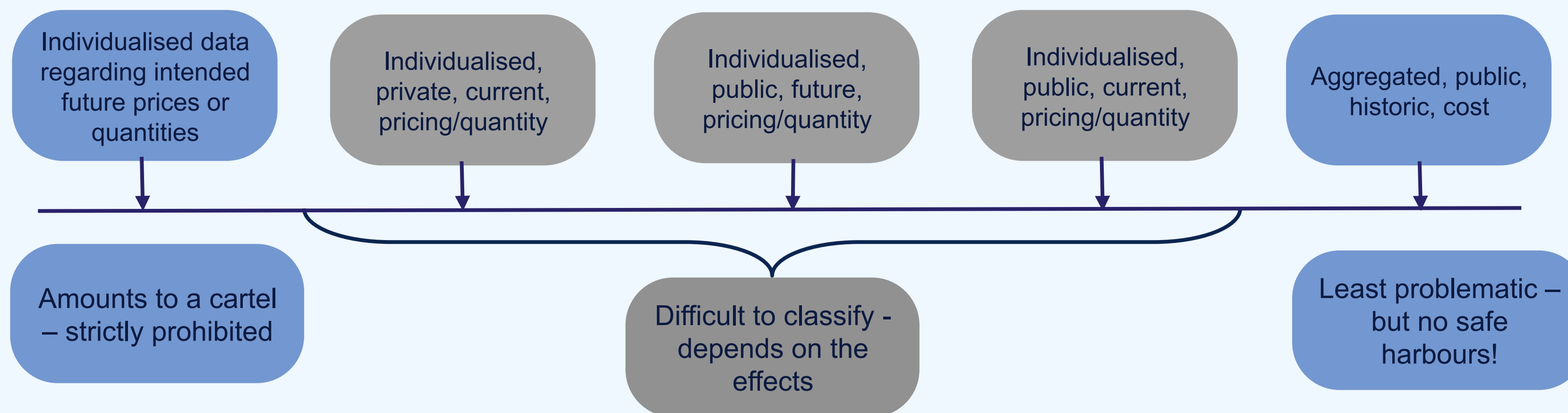
Information exchange

Information exchange

Key issue:

- Element of information exchange required for all JVs to function
- What can be exchanged at which level
  - Parent level
  - JV level
  - Between Parent and JV level
    - Firewalls may need to be considered
    - Particular cautioned required if parents and JV active on the same market

Information exchange – the EU position



EU guidelines attach significance to a number of factors:

Market factors	Information type
Concentration	Commercially sensitive?
Transparency	Disaggregated?
Similar competitors	Public / private
Demand uncertainty	Current / future
Complex markets	Strategic variable?

Could the exchange impact on key parameters of competition quantity, product quality, product variety and/or innovation?

Information exchange in JVs

Competition concerns?

Collusive outcome: by increasing transparency in the market, the exchange of strategic information can facilitate coordination

Anti-competitive foreclosure:

Restriction of competition by object: information exchanges between competitors of individualised data regarding intended future prices or quantities

Restriction of competition by effect: a case-by-case analysis of the market conditions in which the exchange of information takes place

Example in production JV

A and B set up JV in order to produce new product X

They need to share information on e.g. production costs, intended volumes

Exchange not anti-competitive to extent that it is necessary for production of X

To avoid competition concerns:

- No exchange going beyond the scope of production of X

- No unnecessary exchange e.g. intended pricing of X or customer lists

- Firewalls to keep apart those in A and B involved in sales

Spill-over effects of JVs
- Application of Article 101 under the EU Merger Regulation

General principles

Where the formation of a JV raises a risk of coordination of the competitive behaviour of its parents (“spill-over effects”), the Commission carries out a substantive assessment under Article 101 TFEU of any such spill-over effects:

> *“To the extent that the creation of a joint venture constituting a concentration … has as its object or effect the coordination of the competitive behaviour of undertakings that remain independent, such coordination shall be appraised in accordance with the criteria of Article [101](1) and(3) of the Treaty, with a view to establishing whether or not the operation is compatible with the common market.”* (Article 2(4) EUMR)

- Accordingly, full-function JVs, which may give rise to spill-over effects are subject to two tests:
  - “The significant impediment to effective competition” test (“SIEC”)
  - Article 101 TFEU for any spill-over effects

The Commission's analytical framework

In appraising whether a JV gives rise to spill-over effects, the Commission is required to take into account two matters Article 2(5) EUMR):

- *"whether two or more parent companies retain, to a significant extent, activities in the same market as the joint venture or in a market which is downstream or upstream from that of the joint venture or in a neighbouring market closely related to this market."*
- *"whether the coordination which is the direct consequence of the creation of the joint venture affords the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products or services in question."*
- Therefore, to assess the risk of spill-over effects arising between a JV's parents, the Commission:
  - first, identifies the markets to be examined, *i.e.*, the "candidate markets" for coordination
  - second, assesses the likelihood of spill-over effects on the basis of a number of criteria
- Economic conditions play significant role in the Commission's analysis (e.g. *Fujitsu/ Siemens*)

The Commission's substantive criteria

In assessing the likelihood of a JV giving rise to spill-over effects, the Commission takes into account the following criteria:

- **Causality**: is there a causal link between the formation of a JV and the risk of spill-over effects? (e.g. *Téléfonica/Portugal Telecom/Médi Telecom* and *Arcelor/ThyssenKrupp/Steel 24-7*)
- **Appreciable restriction of competition:** do the parents have sufficient market power to make coordination worthwhile?
  - parents' market shares: do the parents hold high market shares?
  - competitive overlap between the parents: are the parents significant competitors?
  - actual and/or potential competition: do the parents face substantial actual and/or potential competition?
  - competitive dynamics: how does the nature of competition affect the scope for competition? (e.g. *Ericsson/Nokia/Psion*)
  - market characteristics: is the market structure conducive to coordination? (e.g. *Fujitsu/Siemens*)
  - incentive for coordination: do the parents have incentive to coordinate? (e.g. *NC/Canal+/CDPQ/Bank America*)
- **Appreciable effect on trade between Member States**: coordination on markets outside of the EU usually not relevant

Individual exemption under Article 101 (3) TFEU

Article 101 provides that agreements having appreciable anti-competitive effects are not valid unless they benefit from an exemption under Article 101 (3)

- For a JV to benefit from an exemption under Article 101 (3), it must be demonstrated that:
  - competition is not eliminated
  - each restriction is indispensable
  - consumers may be expected to benefit
  - production/distribution will be improved
- To date, the Commission has not applied Article 101(3) to any JV where a risk of spill-over effects has been identified
  - Undertakings accepted where the risk of spill-over effects was significant (*BT/ AT&T*, *Areva/Urenco/ETC JV*, *Fujitsu/Siemens,* etc.)

What happens if the Commission identifies spill-over effects?

JVs that gives rise to appreciable spill-over effects and do not satisfy the Article 101 (3) criteria may be prohibited although to date <u>no such transaction has been blocked</u>

- As of 31 December 2011, around 110 decisions rendered under the EUMR looked at possible spill-over effects of JVs, the most detailed analysis being in telecoms and Internet areas.
  - Phase I remedies to address spill-over effects required in a small number of cases: (e.g. *Fujitsu/Siemens, Canal+/CDPQ/Bank America, etc.*)
  - Phase II investigations: (e.g. *BT/AT&T, Areva/Urenco, etc.)*
- The EUMR does not specify whether the assessment of spill-over effects may be undertaken only at the time of notification or the Commission may continue to examine spill-over effects after clearance
  - <u>Majority view</u>: once the Commission has approved a JV under the EUMR, a subsequent Article 101 review for spill-over effects is excluded

EU vs. German merger control: spill over effects of JVs

While the European Commission must examine the potential anti-competitive effects of a JV in the framework of its merger control proceedings, the German Federal Cartel Office ("FCO") has discretion to clear a JV and subsequently conduct a review under Article 101 TFEU and its German equivalent for possible spill-over effects.

- This may lead to increased legal uncertainty for businesses as demonstrated by recent case law:

Chemicals trading JV dissolved by FCO

- In November 2012, the FCO ordered the dissolution of CVH Chemie-Vertrieb cleared about 16 years ago.

Increased scrutiny over JV in the rolled asphalt sector

- Following its inquiry into the rolled asphalt sector, the FCO found a network of corporate links among the four major players, in particular through shareholdings in a number of JVs (final report as of 1 Oct 2012)
- The FCO called on the companies involved to dissolve the problematic structural links within the next 15 months. Upon expiry of this deadline, the FCO itself may institute proceedings

Thank you for your attention!

Questions?

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