Joint venture review under the new EC Merger Regulation

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After more than two years of application, the new EC Merger Regulation\(^1\) has proved that it is able to meet the high expectations of practitioners around Europe. Particularly with regard to joint ventures, its general perception is largely positive. In this article, joint venture review under the new ECMR and the radical changes this brought with it will be briefly illustrated, together with an analysis of first practical experiences with the new regime.

General

Generally, the term ‘joint venture’ is used very broadly by the general public. Arrangements referred to as joint ventures range from transactions akin to mergers to mere cooperation agreements for research and development, production or distribution. Common synonyms are ‘strategic alliance’ or simply ‘cooperative agreements’. EC competition law, however, takes a narrower view, defining joint ventures as undertakings that constitute a separate and fully-functional business entity that is ‘jointly controlled’ by at least two parents.

Joint ventures are economically of utmost importance for the pooling of resources by different companies. A new entity, the joint venture, is created either to complement or integrate some other form of activity of its parents or to develop an entirely new area of business activity for its parents. In its 1993 Notice concerning the Assessment of Cooperative Joint Ventures under article 85 EC Treaty,\(^2\) the European Commission identified numerous economic purposes for the setting up of a joint venture, including research and development joint ventures, sales or purchasing joint ventures and production joint ventures.

Not surprisingly in the light of these manifold intentions to be accomplished by joint ventures, the classification and assessment of joint ventures in terms of EC competition law is complex. As a special, institutionally fixed form of cooperation between undertakings, they are versatile instruments at the disposal of the parents. In its 1993 Notice concerning the Assessment of Cooperative Joint Ventures under article 85 EC Treaty,\(^3\) the European Commission identified numerous economic purposes for the setting up of a joint venture, including research and development joint ventures, sales or purchasing joint ventures and production joint ventures.

Whereas the control of concentrations is at the heart of the ECMR, a cooperation of competitors is generally looked at exclusively under the perspective of article 81 EC Treaty.

In an attempt to cut this knot, the ‘old version’ of the ECMR prior to 1997 excluded from its jurisdiction any joint ventures that would give rise to coordination of the competitive behaviour of the parties among themselves or between them and the joint venture and dealt exclusively with ‘pure’ concentrations. This artificial distinction – which did not correspond to any economic categorisation – led to lengthy discussions between the Commission and the parties over whether a particular joint venture was concentrative and thus within the scope of the ECMR, or cooperative and, thus, outside the ECMR. Consequently, it was abandoned already in the course of a reform of the ECMR in 1997; since then, the difference between concentrative and cooperative is no longer determinative for the application of the ECMR.

This approach has been upheld by the new ECMR, which applies to all joint ventures having a community dimension – determined by certain turnover thresholds – over which the parent companies exercise joint control and which can be qualified as fully functional. These pre-requisites will be discussed below. But before turning to the prerequisites of the new ECMR, the treatment of joint ventures not requiring a filing under the ECMR shall be briefly illustrated.

Joint ventures outside the scope of the ECMR

Should the thresholds of article 1 ECMR, as discussed below, not be met or should the joint venture not be fully functional pursuant to article 3 paragraph 4 ECMR, it will fall outside the ECMR and will be materially judged pursuant to article 81 EC Treaty. In such case, following EC regulation 1/2003,\(^3\) the parents creating a joint venture themselves have to determine the legality of the latter, contrary to the procedure applied by the EC before the 2003 antitrust law reform which required the parties to notify every joint venture to the European Commission.\(^4\)

Given the considerable amount of legal uncertainty inherent in this new approach – which is not alleviated by the remarkable amount of case law and guidelines of the European Commission relating to the examination standard of articles 81 and 82 of the EC Treaty (in particular since these are not tailored to joint ventures) – it becomes an even more significant ‘position of points’ whether a joint venture falls within the scope of the ECMR or not. In the first case, its clearance by the European Commission will eliminate any legal uncertainty as such joint venture is then immune also from any challenge under member state competition laws. Outside the scope of the ECMR, however, a significant amount of legal uncertainty is virtually inevitable (provided that national clearance cannot be obtained).

Joint ventures and the applicability of the ECMR

Having said this, it is incremental for the parties to any joint venture agreement to know whether their joint venture falls within the scope of the ECMR or not. Only joint ventures falling within the scope of the ECMR must (and can) be notified to the Commission. A joint venture is only then deemed to be a concentration in terms

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\(^1\) The European Antitrust Review 2007

**Article 3 paragraph 4 ECMR**

“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) ECMR.”

**Article 2 paragraph 4 ECMR**

“To the extent that the creation of a joint venture constituting a concentration pursuant to Article 3 [ECMR] has as its object or effect the coordination of the competitive behavior of undertakings that remain independent, such coordination shall be appraised in accordance with the criteria of Article 81(1) and (3) of the Treaty, with a view to establishing whether or not the operation is compatible with the common market.”
of the ECMR where a joint venture performing on a lasting basis all the functions of an autonomous economic entity is created. Hence, the concentration term of the ECMR includes all full function joint ventures having a community dimension.

**Community dimension**

A joint venture has a community dimension if certain turnover thresholds are met. As with the old ECMR, also under the new ECMR, a party’s turnover is to be looked at for the financial year preceding the conclusion of the joint venture agreement and encompasses the aggregate turnover of the entire corporate group, including companies in which a parent directly or indirectly holds more than half of the assets, capital, voting rights or board appointments or can otherwise exercise control.

**Turnover thresholds**

Following the primary jurisdictional test as set out in article 1(2) ECMR, the European Commission has jurisdiction to review a concentration if – in the most recent financial year:

- the combined aggregate worldwide turnover of all the undertakings concerned is more than €5 billion; and
- the aggregate community-wide turnover of at least two parties individually is in excess of €2.50 million;
- unless each party to the concentration generated at least two-thirds of its aggregate community-wide turnover in one and the same EC member state.

As a secondary test, article 1(3) ECMR is designed to catch smaller transactions that are nonetheless likely to require a filing in a number of EC member states. Under the secondary test, the European Commission has jurisdiction to review a concentration if:

- the combined aggregate worldwide turnover of all the undertakings concerned is more than €2.5 billion;
- the aggregate community-wide turnover of each of at least two of the undertakings concerned is in excess of €100 million;
- in each of at least three EC member states, the combined aggregate turnover of all the undertakings concerned is in excess of €100 million; and
- in each of at least three of these member states, the aggregate turnover of each of at least two of the undertakings concerned is in excess of €25 million;
- unless each party to the concentration generated at least two-thirds of its aggregate community-wide turnover in one and the same EC member state.

These turnover thresholds have not been altered by the new ECMR. Given the accession of 10 new EC member states in May 2004, however, these thresholds are now easier to meet since the pool of revenues used to satisfy these thresholds on both levels, community-wide and for the individual member states, has been significantly increased, and will further increase through the expected accession of Bulgaria and Romania in 2007.

As with the old ECMR, EC member states’ antitrust authorities remain competent for concentrations where each of the companies concerned achieves more than two-thirds of their community-wide turnover within one and the same member state, irrespective of whether or not the thresholds are actually exceeded. The aim of this exception is to ensure that joint ventures with an effect in mainly one member state remain in the competence of the national competition authority of the affected member state.

**Referral practice**

EC member states’ competences are further enlarged by the new referral procedure under the new article 9 ECMR which makes it significantly easier for member states to request the referral of proposed concentrations with a community dimension to the competent national authorities. Under the old ECMR, pursuant to the so-called ‘German clause’ (due to its history of origin on the basis of German influence), member states could only request such referral if they were able to show that the notified concentration “threatens to create or strengthen a dominant position” on a market within their national borders.

Since joint ventures are assessed with respect to both (i) whether they create or strengthen a dominant position, and (ii) whether they will lead to the coordination of the competitive behaviour among independent undertakings (the latter are also called ‘spill-over effects’), national authorities were in particular prevented from requesting a referral in order to investigate spill-over effects in an individual member state.

This burden has been significantly alleviated by the new ECMR under which member states’ authorities can confine themselves to demonstrate that a proposed concentration “threatens to affect competition” on a market within a member state, provided such market has all the characteristics of a distinct market (article 9 ECMR). Since a “threat to affect competition” is much broader and, therefore, much easier to demonstrate than “a creation or the strengthening of a dominant position”, referrals become substantially easier under the new ECMR. At the same time, article 22 of the ECMR reinforces referrals in the other direction, from the member states to the commission. If companies have to notify a joint venture in three or more member states, they can apply to benefit from a one-stop shop examination of the joint venture by the Commission. In connection with the newly introduced possibility of pre-notification referrals either to the member states (article 4 paragraph 4 ECMR) or to the Commission (article 4 paragraph 5 ECMR), referrals in both directions have been accepted rather frequently since the new ECMR entered into force.

The overall purpose of this new streamlined referral system is to put in place a more rational corrective mechanism of case allocation between the Commission and member states based on subsidiarity, by ensuring that the authority or authorities best placed to carry out a particular investigation should deal with the case.

**Joint control**

According to the Commission’s Joint Venture Notice, a joint venture qualifies as a concentration under the ECMR if it results in two or more entities (that are not part of the same corporate group) sharing joint control over another entity.

**Paragraph 9 Joint Venture Notice**

“A joint venture may fall within the scope of the Merger Regulation where there is an acquisition of joint control by two or more undertakings, that is, its parent companies (Article 3(1)(b)). The concept of control is set out in Article 3(3). This provides that control is based on the possibility of exercising decisive influence over an undertaking, which is determined by both legal and factual considerations.”

**Article 3 paragraph 3 ECMR**

“Control is acquired by persons or undertakings which: (a) are holders of the rights or entitled to rights under the contracts concerned; or (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving therefrom.”
Joint control 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. Thereby, control for the purpose of the ECMR – despite corporate or securities law – is any possibility of exercising decisive influence. According to article 3 paragraph 3 ECMR, joint control may arise as a result of positive or negative measures. It is not necessary for two or more parties to have a total of 50 per cent of the voting capital of the joint venture company. It will suffice that two or more parties can only mutually reach – due to actual or de facto veto rights – certain key decisions that go beyond ordinary minority shareholder rights and which effectively allow them to exercise a decisive influence on the strategic commercial behaviour of the joint venture company. Such rights may include the ability to block the adoption of the business plan or the budget, appointment of senior management, certain capital expenditures, etc.ª

**Full function joint venture**

According to article 3 paragraph 4 of the ECMR, the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration which falls within the scope of the ECMR. This so-called full function criterion is decisive for the ECMR to be applicable.

The Commission has explained in its Joint Venture Notice what it takes for a joint venture to be fully functional.

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**Paragraph 12 and 13 Joint Venture Notice**

"Essentially this means that a joint venture must operate on a market, performing the functions normally carried out by undertakings operating on the same market. In order to do so the joint venture must have a management dedicated to its day-to-day operations and access to sufficient resources including finance, staff, and assets (tangible and intangible) in order to conduct on a lasting basis its business activities within the area provided for in the joint-venture agreement (6).

“A joint venture is not full-function if it only takes over one specific function within the parent companies’ business activities without access to the market. This is the case, for example, for joint ventures limited to R&D or production. Such joint ventures are auxiliary to their parent companies’ business activities. This is also the case where a joint venture is essentially limited to the distribution or sales of its parent companies’ products and, therefore, acts principally as a sales agency. However, the fact that a joint venture makes use of the distribution network or outlet of one or more of its parent companies normally will not disqualify it as ‘full-function’ as long as the parent companies are acting only as agents of the joint venture.”

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The European Commission does not, however, require a new joint venture to be fully functional from scratch; rather, start-up joint ventures are granted a period of grace of up to three years. During this period of time substantial support of the parent company does not contradict the full-function criteria. For example: the Commission has accepted as full function a joint venture that initially only performed joint marketing services and only one year after formation acquired manufacturing capability.¹⁰ Nevertheless, the market expectation for a joint venture to become fully functional must be in existence from the inception of the joint venture company on.¹¹ From the same point of time onwards, the Commission requires that the joint venture is either intended for an indefinite duration or for an initial period of five years with the possibility of renewal; only then will it be regarded as operating on a lasting basis.

It follows from the Joint Venture Notice that it is essential for the joint venture to have production and distribution facilities, management, resources, assets, technology, personnel and a customer base to operate the business as an autonomous economic entity. In that regard, any dependency on the parent companies is viewed critically. Particularly, the strong presence of the parent companies in upstream or downstream markets might be a factor militating against the full-function character of a joint venture. This becomes even more obvious where this presence leads to substantial sales or purchases between the parent companies and the joint venture.¹²

As the focal point, however, the Joint Venture Notice sets out that the essential question is whether the joint venture is geared to play an active role on the market. Having this in mind, the Commission in a recent decision¹³ held that a joint venture’s obligation to buy between 70 per cent and 80 per cent of a certain type of raw material needed for production from or via its parent companies does not alter the full functional nature of the joint venture. Given the qualifications that other competitors were likewise vertically integrated, the Commission decided that such vertical integration was a feature of the affected industry and did not jeopardise the full functional nature of the joint venture.

**Procedure of notification**

Full-function joint ventures are subject to a two-part test under the new ECMR. The first part of the test, to which all concentrations are subject, is set out in article 2 paragraph 3 of the ECMR, determining whether the new joint venture might 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.

The second part of the test, only applicable to full-function joint ventures, is set out in article 2 paragraph 4 ECMR. Under this test, it has to be examined whether the joint venture has as its object or effect the coordination of the competitive behaviour of undertakings (ie, the parent companies) that remain independent. If this is the case, such so-called spill-over effects are subject to review under the prohibition against restrictive agreements pursuant to article 81 paragraph 1 EC Treaty. If necessary, it also needs to be assessed whether the joint venture would generate efficiencies or promote technical progress and benefit consumers in a way that would allow the agreement to be exempted under article 81 paragraph 3 EC Treaty.

**Timeline of the examination procedure**

Joint ventures constituting a concentration with a community dimension must be notified to the Commission. Whereas the old ECMR required such notification within one week after conclusion of the joint venture agreement, under the new ECMR such notification must be filed – without fixed time limits – following the conclusion of the joint venture agreement, the announcement of the public bid, or the acquisition of a controlling interest (in no event must a concentration be consummated before clearance). In practice, however, it may be advisable for the parties – particularly if the Commission has raised concerns during pre-notification contacts – to suspend the conclusion of the joint venture agreement and wait for a decision of the European Commission to implement additional requirements eventually demanded by the Commission to render the joint venture conforming with the EC Treaty. And, what is more, with such practice the parties to the joint venture agreement circumvent the risk of entering into an illegal agreement.

Once notified, the Commission has 25 working days, starting on the day that follows the receipt of the notification, to examine a joint venture in phase one investigations under the new EMCR (this period might be increased to 35 working days if the parent companies propose amendments to the joint venture or a referral
request is received). Should the Commission decide to enter into second phase investigations, it will have an additional 90 working days from the day that follows the decision to carry out an in-depth inquiry (which might be increased to 105 working days if the parent companies have offered remedies after the 54th working day that followed the initiation of the in-depth inquiry; another extension of 20 working days is possible if requested by the notifying parties or by the Commission with the agreement of the notifying parties).

Frequently, the parents are uncertain whether a joint venture agreement actually needs to be notified to the Commission. Generally, the Commission – in its ‘Best Practices on the Conduct of EC Merger Control Proceedings’ – encourages (and expects) the undertakings concerned to establish pre-notification contacts with DG Comp, giving the notifying parties and other involved parties the opportunity, if they so request, to discuss an intended concentration informally and in confidence before notification. Concerning ‘borderline cases’, the Commission tends to advise not to file a notification, in order to avoid taking a final decision.

In any event, if the parents decide to make a filing, it is essential to start with the gathering of information required for the notification as soon as possible. Ideally, initial contacts with the Commission and the gathering of required information for the filing should start weeks if not months before the actual filing. It should be mentioned in this context, however, that certain smaller joint ventures (as described in detail in the Commission’s Notice on Simplified Procedure) benefit from a simplified procedure. The Commission, after being satisfied that the concentration fulfils those requirements, will normally issue a short-form decision, declaring the joint venture compatible with the common market within 25 working days.

**Conclusion**

After more than two years of joint venture review under the new ECMR, the new legal framework has proved to be efficient in its everyday implementation. The EC Commission has so far approved (subject to commitments in some cases) all joint ventures notified pursuant to article 4 of the new ECMR. Over the past 12 months, 49 non-opposition decisions stand vis-à-vis only one (voluntary) withdrawal of a notification.

When looking at these impressive statistics, however, it should be noted that the parent companies have more flexibility with regard to the creation of the particular joint venture in order to circumvent competition law concerns than this is the case, eg, in merger cases. As a consequence, competition law concerns can often be remedied by commitments of the parties during the notification process. Another remarkable consequence of the introduction of the new ECMR is the high number of particularly pre-notification referrals accepted by the competition authorities since its coming into force. This trend shows that the mechanism of case allocation between the Commission and the member states based on subsidiarity is highly appreciated by the legal community.

All in all, the changes the new ECMR brought with it have already proven to render joint venture review both more flexible and more efficient.

**Notes**


2 This notice has been replaced by the Horizontal Cooperations Guidelines in 2000, but remains of assistance on certain matters.


4 However, joint ventures falling outside the ECMR might constitute notifiable concentrations under national merger control laws (eg, in Germany where also non full-functional ventures can be notifiable concentrations).

5 Adjusted for acquisitions and divestitures subsequent to the end.
of the financial year. Furthermore, value added tax and other taxes directly related to turnovers are to be deducted, and intra-group revenues are left out of account.

6 Commission Notice on Calculation of Turnover (98/C 66/04), para 42.

7 According to the Commission's European Merger Control Statistics, 16 pre-notification referrals to member states and 62 pre-notification referrals to the Commission have been accepted until June 2006 under the new ECMR, whereas the number of referrals under article 9 ECMR did not significantly rise under the new ECMR.


11 In a recent decision dated 31 March 2006, the Commission expressly mentioned the secondment and transfer of employees to the joint venture as an indication of its full-functionality, cf Case No. COMP/M.4139 – Sony/NEC of 31 March 2006, para 10; cf also Case No. COMP/M.4232 – Scottish & Newcastle/Kühne+Nagel of 28 June 2006.


13 Case No. COMP/M.3578 – BP/Nova Chemicals/JV of 1 July 2005; a similar position was taken by the Commission in Case No. COMP/M.3099 – Areva/Urenco/ETC JV.


15 The European Court of First Instance's judgment of 13 July 2006, in which it overruled the Commission's clearance of the Sony/BMG joint venture, shall remain out of consideration in this context since this clearance decision has been rendered under the old ECMR.