

TITLE: Regulation of Joint Ventures under Article 81 of EU Treaty

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Abstract:

The paper discusses Article 81 of EU treaty, which focuses on the analysis of the competitive behavior of a joint venture participant in co-operative non-full-function joint venture with focus on telecommunications sector. The Article 81 analyses the joint ventures that fail to satisfy the threshold of the European Commission's Merger Regulation (ECMR) due to the factors that either they are not fully-functional in nature or lack a community dimension.

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Article 81 of the European Union Treaty (Article 81) prohibits " . . . agreements between undertakings, decisions by associations of undertakings and concerted practises which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market..."^I

Article 81 focuses on the analysis of the competitive behaviour of a Joint Venture participant. Joint Ventures that fail to satisfy the threshold of the European Commission's Merger Regulation (ECMR) due to the factors that either they are not fully-functional in nature or lack a community dimension, are analysed under Article 81.^{II}

Co-operative Joint Ventures can be classified in to two broad categories. One, which is governed by merger control regulation viz. Co-operative full-function Joint Ventures and the other regulated under Article 81 viz. Co-operative non-full-function Joint Ventures. The following pages will deal with the scope of Joint Ventures (JV) regulated by Article 81.

Application of Article 81 to Joint Venture

The European Commission's (Commission) notice on co-operative and concentrative JVs describes joint ventures as "undertakings controlled by two more other undertakings"^{III}.

In other words, any arrangement between two undertakings for commercial purposes can be termed as Joint Venture. Joint Ventures as defined by Faull & Nikpay -

^I <http://www.eierskapstilsynet.no/rapporter/artikler/eucommercases.doc>, dt. 04-05-03

^{II} Antitrust Scrutiny of Telecommunications Mergers, Joint Ventures and Strategic Alliances - A Shift From Regulation to Enforcement By Kevin R. Sullivan, Jeffrey S. Spigel and David A. Cohen, <http://www.kslaw.com/library/articles.asp?16>, dt. 04-05-03.

^{III} The EC law of competition Jonathan Faull, Ali Nikpay pg. 348; Oxford University Press, 1999. The chapter was written by F.Enrique Gonzalez Diaz, Dan Kirk, Francisco Perez and Cecile Verkleij

“agreements by which two or more independent undertakings proceed to the partial integration of their business operations, which are put under joint control in order to achieve some commercial goal”^{IV}. While discussing Joint Ventures, it is further important to analyse the antitrust consequences of these Joint Ventures. Joint Ventures give rise to new competitive force in the market. This may further result in anti-competitive spill-over effects.

“Article 81 of the EC Treaty has three elements:

Article 81(1) prohibits certain restrictive agreements and conduct, which may affect trade between EC member states. A number of examples of prohibited arrangements are expressly identified in the text of Article 81, including price fixing, market sharing, and production quotas. This list is non-exhaustive and other types of anti-competitive behaviour may be caught by the prohibition;

Article 81(2) provides that restrictive agreements falling within the scope of the prohibition are automatically void;

Article 81(3) allows the Commission to grant individual exemptions in respect of agreements, which satisfy specified criteria.”^V

Commission views that in the case of vertical agreements (i.e. agreements between firms at different levels of supply) an arrangement may be deemed to have no appreciable effects if the combined market share of the participants is less than 10%. In the case of horizontal agreements (i.e. agreements between competitors) an arrangement may be deemed to have no appreciable effects if the combined market share of the participants is less than 5%. The Commission is of the view that certain types of agreement, for example agreements for fixing of prices or production quotas or those forming part of a network of similar agreements, may be found to have appreciable effects even where the market shares fall below these thresholds. On the other hand, an agreement may be found to have no appreciable effects where these thresholds are exceeded, depending on the particular market structure and conditions.^{VI}

^{IV} See note 3

^V http://www.legal500.com/devs/eu/cp/eucp_001.htm, dt. 04-05 03

^{VI} http://www.legal500.com/devs/eu/cp/eucp_001.htm, dt. 04-05 03

The *GEC-Weir Sodium Circulators decision* of 21st November 1977 describes the competitive risks associated with the formation of a Joint Venture under Article 81. In its finding Commission stated that: setting up of a Joint Venture between two undertakings, which prior to forming a Joint Venture were potential competitors in the same field of activity, is considered to be a restriction of competition due to replacement of two undertakings by one. The collusive effect, either in the Joint Venture market or related one where the parents are in competition, is also a restriction to competition as such. In such circumstances there will not be any competition within the parent and Joint Venture Company. In case the Joint Venture is vertically related to the parent companies, the position of the third parties will be affected, as Joint Venture will be preferred as a source of supply, producing a foreclosure effect restrictive of competition^{VII}.

Under Article 81, the Commission assesses, wherever the parent companies and Joint Venture Company are in vertical relationship, the possible foreclosure effect will be produced.

Role of Potential Competition

The existence of potential competition between the parent companies is determined by the Commission on the presumption relating to the previous activities, expertise and their financial resources. In the thirteenth report on the competition policy, to evaluate whether the formation of a JV in production field restricts potential competition, the Commission has set out a checklist of questions:

1. Input of the Joint Venture: Does the investment exceed the financing capacity and whether the parent companies have technical know-how and source of input products.
2. Production of the Joint Venture: This involves partner's familiarity with the process technology and access to production facilities.

^{VII} Refer to: note 3 pg. 353-354

3. Sales by the Joint Venture: Would it be possible for any of the partners to manufacture the product on its own and whether the distribution channel is accessible by parent companies for the Joint Venture product.
4. Risk factor: Capacity of each partner to take financial and technical risk associated with the production operation.^{VIII}

Spill-over Effects

“A JV also can lead to anti-competitive effects in markets ancillary to the JV market, where the JV partners may either continue to compete or may be potential competitors. Such concerns commonly stem from the partners' access to competitively sensitive information through the JV. These concerns can be addressed through various safeguards, thereby mitigating any potential anti-competitive spill-over effects.”^{IX}

The Commission automatically applies Article 81(1) to a Joint Venture between competitors and to aggregate their market share in the assessment. *Exxon/Shell* decision of 1994, discusses the co-ordination effect in more detail. Joint Venture Company ‘Cipen’, used to produce certain grade of polythene (PE) in Europe, it was decided that the product would be exclusively supplied to the parent companies, and the parent companies would in turn sell PE to the final consumers. The parents companies held 20 percent of EU production capacity and Joint Venture represented 17 per cent of this combined capacity. The Commission concluded that, “the parents would be likely to co-ordinate their behaviour on the EU market for these grades of PE through the Joint Venture. Therefore the agreement fell under Article 81(1)”^X.

Faull and Nikpay further commented, “It is not just the relative importance of Joint Venture to the parents activities on the market that will determine whether they will

^{VIII} Refer to: note 3 pg. 357.

^{IX} Antitrust Scrutiny of Telecommunications Mergers, Joint Ventures and Strategic Alliances - A Shift From Regulation to Enforcement By Kevin R. Sullivan, Jeffrey S. Spigel and David A. Cohen, <http://www.kslaw.com/library/articles.asp?16>, dt. 04-05-03.

^X Refer to: note 3 pg. 360-361.

co-ordinate their behaviour, the greater the parent combined market share on the market the stronger the incentive there is for them to co-ordinate and hence a smaller Joint Venture can be a source of anti-competitive co-ordination”.^{XI}

The issues that are supposed to be addressed while assessing the applicability of Article 81 are (1) the restriction of actual or potential competition on parties to the Joint Venture (2) the effect on third parties and; (3) network effect.^{XII}

The Commission stand, as to take an economic analysis of the incentives on the parents to co-ordinate their behaviour and effects, was reconfirmed in the decision of *European Night Services*.^{XIII} The court upheld the earlier decision, stating that the Commission had not taken sufficient economic reasoning in its original decision that the agreements fell under Article 81(1).^{XIV}

The possible link of a Joint Venture with a downstream market was dealt in *Philips / Osram* decision of 1994. The Joint Venture was to manufacture lead glass tubing for lamps. The case was assessed under Article 81 because the parties had 65 per cent of the EEA capacity for producing lead glass. Parties also produced final lamps and were also competitors in most segments of downstream market. The costing of lead glass tubing was only 0.67 per cent of the lamp. Here the Commission concluded that 'given the very small importance on lead glass on the manufacturing cost of lamps, such standardisation is not considered relevant enough as to constitute a restriction of competition'.^{XV}

^{XI} Refer to: note 3 pg. 361.

^{XII} EC Competition Law, Alison Jones and Brenda Sufrin, pg.825. Oxford press 2001

^{XIII} Joined cases T-373/94, T-375/94, T-384/94 and T-388/94 *European Night Services Ltd (ENS)*, judgement of 15 Sept 1998. Also refer to- *The EC law of competition* by Jonathan Faull, Ali Nikpay. Pg. 361; Oxford University Press, 1999. The chapter was written by F.Enrique Gonzalez Diaz, Dan Kirk, Francisco Perez and Cecile Verkleij.

^{XIV} Refer to: note 3 pg. 361.

^{XV} Refer to: note 3, pg. 361.

Network Effects

The Commission is also concerned, when in a concentrated market a single technology provider may get into Joint Venture with different partners and may deter them from competing with each other. While discussing this kind of a network effect or network of joint ventures, in *Optical Fibres case*, the Commission found that each individual joint venture did not restrict competition, since parties contributed complimentary technologies.^{XVI} The Commission further stated that “a network of Joint Ventures does not infringe Article 81(1) when provider of a technology has substantial interest and control over each Joint Venture and the market is oligopolistic. Its theory is that Corning might use the control over one Joint Venture to prevent its expansion in order to protect one of the others.”^{XVII}

An express restriction of competition between the parents of a Joint Venture, resulting into fixing of prices or share markets would be regulated under Article 81(1).

While giving its views on the joint sales organisations, the Commission cleared a joint sales organisation as not having appreciable effects in *SAFCO* whereby small markets of preserve were able to penetrate the German market whereby they met substantial competition.^{XVIII}

The European Court of Justice (ECJ) is of the view that, with small market share, organisations involved in co-operative buying and selling do not infringe Article 81(1). In *Korah's* views, a joint sales organisation cannot restrict production to raise price unless the parties accept restrictions on production or agree to share prices.^{XIX}

In another case, *P&O/Stena, P&O ferries and Stena lines* formed a Joint Venture for providing channel ferry services across Short French Sea and the Belgian Straight. Two markets involved were passenger services and freight services. The Joint

^{XVI} EC Competition Law and Practice, Valentine Korah, pg.333. Hart Publishing, 2000

^{XVII} Refer to: note 16, pg.334.

^{XVIII} Refer to: note 16, pg.331.

^{XIX} Refer to: note 16, pg.332.

Venture was held under Article 81(1) because parties were actual competitors. After analysis it was concluded that the Joint Venture company and Eurotunnel are likely to compete rather than to act in parallel to raise prices.^{XX}

In the year 1993, British Telecom (BT) and MCI Communications Corp. (MCI) announced a \$US 4.3 billion global alliance. The venture comprised two transactions-

- (1) BT would acquire a 20 percent stake in MCI for \$US 4.3 billion, thereby making BT, MCI's largest shareholder.
- (2) BT and MCI would create a new JV - Concert, to which each company contributed certain businesses.

The Concert would pursue the companies' goal of providing global telecommunications services to multinational customers. As part of the alliance MCI would market Concert services in America, while BT would market Concert in the rest of the world. At the time when transaction was announced, BT was the world's fourth largest telecommunication services provider with dominant position in local and long distance services in United Kingdom. MCI was the second largest long distance Company in the United States, and the world's fifth largest telecommunications carrier. The EC found the Concert "cooperative" JV to restrict competition because BT and MCI were potential competitors in the overall market for telecommunications, as well as in the value added global services segment in which Concert would participate.^{XXI} In the case of *BT/MCI* Joint Venture, the Commission granted exemption on the condition that users in the European Economic Area (EEA) may also avail services through MCI in addition to incumbent BT. This would be valid even during the 5-year agreement period under which both were under obligation to not to provide services in each others geographical territory.^{XXII}

^{XX} Refer to: EC Competition Law, Alison Jones and Brenda Sufrin, pg.827-829. Oxford press 2001

^{XXI} Refer to note 9.

^{XXII} EC Competition Law and the new economy of Information Technology, by Prof Steve Anderman, pg30. Draft paper, 23/10/02, University of Essex.

In the *ATLAS*^{XXIII} case the Commission dealt with Joint Venture between a French and a German national telcom operators to provide a range of complex communication package.^{XXIV} *France Télécom ("FT") and Deutsche Telekom ("DT")* proposed to purchase \$US4billion of Sprint Corporation's (Sprint) stock and form a global telecommunications venture, known as Global One. The venture would provide not only voice but also data transmission and other enhanced telecommunications services. As part of the transaction DT and FT would separately enter into a JV - Atlas, for provision of telecommunications services in the EU. Atlas would then serve as the vehicle for FT and DT's JV with Sprint. DT and FT were the world's second and fourth largest telecommunications providers, respectively; as well as the two largest European telecommunications firms. They also at that time, were the monopoly telephone service providers in their respective home countries. In the U.S., Sprint was the third largest long distance carrier after AT&T and MCI.^{XXV} The Commission granted an exemption to the Joint Venture despite the substantial elimination of the competition between the parents. The Commission was of the view that consumers would benefit from the improved technology and this would enable better technical harmonisation.^{XXVI}

In another case of *Eirpage*, the Commission granted an exemption to a Joint Venture agreement between Bord Telecom Eireann (BTE) and Motorola Ireland Ltd for creation and operation of National paging system. It is evident from the above decisions and cases that the Commissions concern is only to prevent early leadership resulting into premature foreclosure since this would prevent competition and innovation of new technologies.

To grant an exemption under Article 81(3), the Commission has to show that the agreement does not impose on the undertaking concerned restrictions, which are not

^{XXIII} [1996] OJ L239/29, [1997] 4 CMLR 89.

^{XXIV} Refer to: note 20, pg.829.

^{XXV} Refer to note 9.

^{XXVI} Refer to: note 24.

indispensable to the attainment of objectives such as improvement of production or distribution of goods.^{XXVII}

Application of Article 81 to Research and Development Agreements

The Commission considers that, in order to assess the applicability of Article 81(1), it is not only sufficient to envisage the competition between parties, but it is also necessary to consider whether an R&D agreement is likely to affect competition to such an extent that negative effects can be expected. To assess whether an R&D is likely to cause such a negative effect on the market, the economic context must be considered, taking into account the nature of the agreement and the party's market power. The purpose behind the cooperation is an important factor in determining whether an R&D agreement per se has any anti-competitive effect. If the true object of an agreement is not R&D but the creation of a disguised cartel (i.e. otherwise prohibited price fixing), output limitation or market allocation, it shall fall under Article 81(1) and the same shall not be permitted. For e.g., the sharing of markets or customers reduces the choice available to customers and leads to higher prices or reduced output. Consequently, those forms of co-operation are almost always prohibited.^{XXVIII} Thus dealing with Research and Development Joint Ventures, if the object of an agreement is to create disguised cartel, instead of R&D, it would fall under Article 81(1) and Article 81(1) would apply. The guideline also say that Article 81(1) is not infringed merely because the parties have more than 25% market share but if the parties position of the parties on the market becomes stronger.

“R&D agreements that cannot be assessed from the outset as clearly non-restrictive may fall under Article 81(1) and have to be analysed by taking into consideration the market-related criteria such as the market position of the parties, and other structural factors. Different forms of cooperation in R&D may be assessed differently as regards their acceptability under Article 81(3). That assessment very often depends on the

^{XXVII} Refer to: note 3, pg. 357.

^{XXVIII} <http://firms.findlaw.com/KAYNAKLAR/affiliate5.htm>, dt. 04-05-03

stage in which the cooperation is carried out. Pure R&D agreements, as explained above, are most likely to be exempted.”^{XXIX}

The Commissions policy towards potential competition is set out in *Elopak / Metal Box – Odin Decision*. Elopak and Metal Box agreed to set up a Joint Venture, Odin, to research develop and ultimately manufacture and distribute a new type of packaging. The technology was new and involved contributions from both the parents. In Commissions view, neither party in the short term would enter the market alone, as such entry would require a knowledge of other party’s technology, which otherwise for development requires time consuming investment. Therefore it was not regarded as potential competition and Joint Venture did not fall within Article 81(1). Article 81(1) applies to agreements where parties are actual or potential competitors.^{XXX}

Conclusion

The Joint Venture between two companies may unite their economic interests thus facilitating restrictive arrangements or creation of anti competitive spill-over effects.^{XXXI} Joint Ventures where the parent companies are in actual competition or are potential competitors are regulated under Article 81(1).

As pointed out by Professor Hawk, ‘ by applying Article 81(1) to the co-ordination of the competitive behaviour of the parent companies and also to the pooling of activities in the Joint Venture, the Commission was likely to treat the potential for efficiencies created by co-operated full function Joint Venture more harshly than the equivalent potential for efficiencies stemming from the setting up of a concentrative Joint Venture.’^{XXXII}

^{XXIX} Refer to note 28

^{XXX} Refer to: note 3, pg. 373-374.

^{XXXI} Refer to: note 3, pg. 349.

^{XXXII} Refer to: note 3, pg. 353.