This document is submitted to the Committee on Competition Law and Policy FOR DISCUSSION at its forthcoming meeting on 24-25 October 2000. The following document is, except for one correction, the same as the one attached to the Secretariat’s letter of June 30th (CLP/2000.90) concerning the mini-roundtable on joint ventures. The correction was made in the question found in Section III of the paper, under point three of the “Suggested discussion points”. The Secretariat wishes to thank the Italian delegation for pointing out the need for this correction.
Downsizing, divestment, mergers, acquisitions - these dominate the headlines. But the greatest change in corporate structure, and in the way business is being conducted may be the largely unreported growth of relationships that are not based on ownership but on partnership: joint ventures, minority investments cementing a joint-marketing agreement or an agreement to do joint research; and semi-formal alliances of all sorts. [Drucker (1999, 798)]

I.

Introduction

1. Joint ventures are a competition policy growth area in which complex tradeoffs must be made between pro- and anti-competitive effects, and among various enforcement approaches. Moreover, it is an area where competition officials have come under pressure from the business community and parts of government and academia to clarify and liberalise policy ostensibly in order to improve dynamic efficiency and international competitiveness.

2. This note is intended to facilitate discussion of joint ventures by sketching out the important issues, posing some questions delegates might wish to explore, and steering the reader to some useful bibliography.

II.

Definition

3. There are many ways in which joint ventures could be defined for competition policy purposes. Here is a small sample:

...entities that play a role in the marketplace in their own right and are owned or controlled by two or more persons...that are neither ordinary investors nor commonly controlled. [Werden (1998, 701-702) - footnotes omitted]

...an integration of operations between two or more separate firms, in which the following conditions are present: (1) the enterprise is under joint control of the parent firms, which are not under related control; (2) each parent makes a substantial contribution to the joint enterprise; (3) the enterprise exists as a business entity separate from its parents; and (4) the joint venture creates significant new enterprise capability in terms of new productive capacity, new technology, a new product, or entry into a new market. [Brodley (1982, 1526) - cited by Werden (1998, 701)]

In the past - and to some extent, still today - practitioners and business executives have used the term "joint venture" to refer to a separate corporation owned by independent parents. A broader definition includes all cases where firms collaborate in carrying on some activity that each firm might otherwise perform alone. Sometimes the term has been used to refer to virtually any collaboration by competitors, short of merger. These definitions sweep in a vast range of joint activity, from a highly integrated production joint venture, to a loosely integrated marketing network, to a set of ethical rules regarding advertising. [Correia (1998, 738) - footnotes omitted]

4. For the purposes of this paper, "joint ventures" will be defined as participating firms agreeing by contract or otherwise to combine, other than by merger, significant productive (tangible or intangible)
assets, and to do this by going beyond ad hoc co-operation. Crucially, they agree to perform a business function rather than simply agreeing to make a business decision in common. Inter-firm agreements that do not qualify as joint ventures will be referred to as "agreements".

5. Exactly how joint ventures are defined, and in particular how they are distinguished from mergers, could be critical in certain jurisdictions. This is because there could be important procedural differences in how joint ventures (or agreements in general) and mergers are treated.

Suggested discussion points

1. Please supply any definition of joint venture or strategic alliance, either general or specific to certain activities, contained in your law, regulations (including block exemptions), or policy guidelines. If there is no such definition, please describe how the courts in your jurisdiction define joint ventures. Regardless of where the definition is found, please describe how your jurisdiction distinguishes between joint ventures on the one hand, and agreements or mergers on the other.

2. Do you have any data or, failing that, anecdotal evidence indicating a marked change in the last few years in the incidence of joint ventures? Does any such trend occur across the board or is it concentrated in certain sectors, and if so, which ones? If there is an increasing or decreasing use of joint ventures, what appear(s) to be the underlying cause(s)? How, if at all, are trends in the use of joint ventures related to:
   a. globalisation; or
   b. changes in enforcement policies towards alternative methods of inter-firm collaboration, i.e. other agreements and mergers?

III. Why do firms engage in joint ventures, and how do competition agencies deal with them?

6. Assuming that firms wish to combine in various ways to obtain greater efficiency and/or market power, why do they choose to do this through a joint venture rather than either a more ad hoc arrangement, or a merger? In theory, a joint venture could be mimicked by continuous detailed co-operation in making decisions about the use of resources remaining under the separate control of individual participants. A joint venture could, however, accomplish this with lower transactions and organisation costs. A degree of integration should foster greater commitment and trust than would a mere agreement, hence spare the parties having to fully specify their legal relationship in advance. Compared with a merger, a joint venture might be easier, quicker and cheaper to arrange, and permit a more flexible, hence efficient joining of forces. It could also be less commercially risky and easier to undo than a full-fledged merger.

7. There are no doubt some cases where participants agree to perform through a joint venture something which would not or even could not be undertaken by each participant acting alone. Except for such cases, joint ventures will involve some loss of actual or potential competition. It follows that an adequate competition policy towards joint ventures should consider both their pro- and anti-competitive effects.

8. Assessing a joint venture’s pro-competitive effects essentially involves considering the static and dynamic efficiencies obtained through co-operation to develop and perhaps produce new products, processes or means of distribution. As for anti-competitive effects, assessment would normally begin by examining the terms of a joint venture’s founding agreement(s) including: the governance structure
adopted; the joint venture’s duration; and the nature and extent of assets transferred to the joint venture versus those retained by the participants. The principal focus of this analysis would be to ascertain the degree to which the participants retain the freedom, ability, and incentive to compete with the joint venture and/or each other. Any exclusivity clauses affecting third parties would also deserve attention. Assuming that inter-party competition will be constrained in some way, the investigation may have to be broadened to include making a formal market definition, estimating concentration levels, and considering the significance of any barriers to entry.

9. Clearly the above analysis should not apply to a sham joint venture, especially one containing sub-agreements ordinarily subject to summary condemnation and heavy sanctions, i.e. “naked” price fixing, output reductions, or market allocations. Scarce enforcement resources should not be expended assessing what, absent the disguise, is simply a “hard core cartel”. The more difficult policy questions are whether and how competition agencies should:

   a. improve the transparency and predictability of their joint venture analysis;
   b. not only review a joint venture taken as a whole, but also engage in a supplementary examination of any sub-agreement that might have anti-competitive effects taken by itself; and
   c. work with joint venturers to encourage them to make commitments designed to reduce the risks of anti-competitive effects; and
   d. reduce the sanctions applied to anti-competitive sub-agreements found in otherwise legitimate joint ventures.

10. It is difficult to spell out how a competition agency will analyse arrangements as potentially diverse as joint ventures. Nevertheless, even a general guide could prove helpful to businesses and their advisors and thereby facilitate arrangements benefiting consumers. Without such assistance, firms could understandably hold back from entering some net pro-competitive joint ventures. This is especially true of joint ventures which participants believe must contain sub-agreements that, standing alone, would be viewed as hard core cartels. It is important to draw a clear line between what will and will not be subject to summary condemnation coupled with severe penalties.

11. Competition review of joint ventures might include two parts. The first part would perform at least a preliminary balancing of the joint venture’s pro- and anti-competitive effects. In some cases, this preliminary test would be sufficient to condemn or clear the joint venture. However, in cases where the analysis appeared inconclusive and/or sub-agreements having clear anti-competitive effects were found, part two would apply. Each of the problematic looking sub-agreements would be subject to close scrutiny. For example, the competition agency could ask whether: a) the restraint is reasonably connected to the joint venture, and if so; b) is it necessary to the achievement of the joint venture’s pro-competitive efficiencies? If either of the answers are negative, the restraint, but not the joint venture as a whole, would be prohibited. Such treatment would be especially appropriate for a restraint which, standing alone, would be summarily condemned as a hard core cartel. If the sub-agreement is instead reasonably connected to the joint venture and necessary to achieve its pro-competitive efficiencies, the competition agency could accept or reject it depending on its net competitive effect.

12. Neither part of the suggested approach would be easy to apply, but the second would be particularly difficult. The problem is how to define “necessary” in this context. A restraint on competition could be absolutely necessary in that the joint venture would be abandoned without it. Or it could be necessary in the sense that it is the least anti-competitive way in which certain pro-competitive effects can
be assured. Or, as a kind of middle ground, a restriction could simply make a joint venture more attractive to its participants because it helps ensure commitment and reduces free riding.

13. Competition agencies could decide to go somewhat beyond the kind of analysis sketched out above. To be specific, they could encourage commitments that would make a joint venture less likely to be anti-competitive. For example, joint venturers could be urged to keep certain assets out of a joint venture, refrain from giving it any marketing functions, and/or licence third parties to use technology or products discovered or perfected by the joint venture.

14. As for the level of sanctions that should be applied to joint ventures, this too turns out to be a bit complicated. If a joint venture, other than a sham, is found to be anti-competitive at something like what was described above as part one of the analysis, there seems to be little reason for going much beyond prohibiting it. It should probably be treated approximately like a prohibited anti-competitive merger. If instead, during part two of the analysis, anti-competitive sub-agreements are found that are not sufficiently connected to the joint venture, there may be good grounds for subjecting them to the same penalties attaching to the behaviour outside a joint venture context. For example, in the context of a joint venture to produce automobile parts, an agreement to fix the price of refrigerators should presumably be punished as “naked” price fixing. Moving away from this extreme, which is akin to a sham, things get more difficult. If there is some reasonable connection to the joint venture and to the realisation of its pro-competitive efficiencies, but a clause is nevertheless prohibited because of its net anti-competitive effect leniency seems warranted. In specific, a prohibited clause should perhaps benefit from more favourable treatment than would have been meted out to the same type of behaviour outside the joint venture context. Such leniency could be justified on fairness grounds as well as on a desire to avoid a chilling effect on pro-competitive joint ventures.

15. A desire to avoid a chilling effect seems to have motivated a number of competition agencies to publish enforcement guidelines regarding joint ventures. Some countries have gone considerably further by adopting what amount to special joint venture regimes. There appears to be considerable variation in this domain, but broadly speaking, one or more of the following measures have been used:

   a. employing various presumptions and burden shifting provisions to fine tune the treatment accorded to joint ventures;
   b. subjecting joint ventures to lower penalties;
   c. providing a safe-harbour exemption for joint ventures falling below certain market share thresholds; and
   d. providing general (block) exemptions for qualifying joint ventures.

There are a number of permutations possible in the above. For example, explicit joint venture policies could be limited to R & D or production so as to exclude co-operation on marketing functions. In addition, some kind of notice could be required for joint ventures to be eligible for more lenient treatment, and the treatment itself could be either permanent or time limited.

Suggested discussion points

1. Which, if any, types of competitive restraints are subject to summary condemnation in your jurisdiction, i.e. prohibited without much regard to their pro- or anti-competitive effects? If such arrangements appear as part of a legitimate joint venture, how are they treated?
2. In order to be permitted in a joint venture context, do you require evidence that apparently anti-competitive clauses or sub-agreements are: a) reasonably linked to the joint venture’s pro-competitive effects; and b) that they are also somehow necessary to achieve the joint venture’s positive impact? If so, please describe the kind of evidence and factors you look for in order to make this determination. Do you insist that any competitive restraints found in a joint venture, represent the least anti-competitive means of attaining its pro-competitive effects? If so, please describe the kind of evidence you look for in order to make that assessment.

3. Do you encourage joint venturers to make commitments designed to ensure that their joint venture does not have a net anti-competitive effect (i.e. commitments intended to reduce anti-competitive effects and/or to enhance offsetting pro-competitive efficiencies)? If so, please cite some representative examples and describe whether such commitments were enforceable or not, plus any steps taken to reduce associated monitoring costs.

4. If your country has an identifiable competition policy applied to "joint ventures" (as you define them), does it apply only if they have a particular legal form (e.g. equity participation in a separate legal entity), or a certain degree of permanence? If that is the case, why is it so?

5. If there has been empirical research tending to show that your joint venture laws and policies are either too liberal or not liberal enough, please identify that research and summarise the findings.

6. Does your agency balance the pro- and anti-competitive effects of a joint venture using a different "surplus" standard than it applies to mergers? For example, you might apply a strict consumers’ surplus approach to joint ventures (e.g. cost reductions must be so great that price(s) will fall despite any increase in market power), but a more liberal total surplus approach to mergers [i.e. focus on net changes in the combined total of consumers’ plus producers’ surplus]. Please explain, if pertinent, why two different standards are being applied.

7. Are there plans afoot in your jurisdiction to modify or introduce policies applied to joint ventures? If so, please describe why these changes are being contemplated.

8. Please describe in detail one or more recent joint venture cases that your agency has worked on.

IV. International Aspects of Joint Ventures and International Co-operation Among Competition Offices

16. In terms of frequency and the size of firms involved, international joint ventures appear to be more and more important. Moreover, as globalisation continues, even joint ventures confined to domestic firms could increasingly affect other countries’ consumers. Although there is no necessary reason why joint ventures with international effects should be either more or less pro- or anti-competitive than strictly domestic joint ventures, they do face some particular problems. The balance of pro- to anti-competitive effects could vary from one country to another, and even where this is not the case, dissimilar competition policies could produce across country variations in treatment accorded to joint ventures having international effects. Complementing this point, competition agencies may experience pressure to give lenient treatment to both domestic and international joint ventures on the grounds that they are needed to assure the international competitiveness of a nation’s firms.

1. For more description of the difference between the consumers’ and total surplus approaches, see Williamson (1988).
17. Thus, there may be room for soft convergence in laws and enforcement policies as regards joint ventures. There might also be support for measures to co-operate in investigating and devising remedies for joint ventures, especially those having international effects.

**Suggested discussion points**

1. Please describe any international joint venture cases you have dealt with where there have been differences in treatments accorded by the competition offices involved. In such cases, would facilitating information exchange or assisting in other jurisdictions’ investigations have contributed to more similar resolutions being adopted in each country? Why or why not?

2. Please give examples, if there are any, of your agency co-operating with competition agencies in other jurisdictions on joint venture cases. Whether or not you have had such cases, what do you see as the main costs and benefits of such co-operation?

3. Please present any evidence you may be aware of that across country differences in policies towards joint ventures have prevented companies from making better use of international joint ventures, or have resulted in competitive distortions, i.e. one set of firms has been favoured over another.
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