Joint ventures and assessment under the TPA

Mark Pearson, General Manager of the Commission's Mergers and Asset Sales Branch, has written the following article about joint ventures — defining them in practical terms, and analysing how they are treated under the Trade Practices Act. He examines their competition effects, their benefits and whether the merger provisions of the Act are adequate in assessing them.

Joint ventures are a widely used commercial arrangement that may encompass a broad range of legal and commercial relationships. Commentators note that the term 'joint ventures' may refer to arrangements along a broad continuum — from low level collaborations and alliances to potentially highly anti-competitive cartel-type dealings. In part, it is this breadth of subject that has led some antitrust authorities, such as in the European Union and the United States of America, to articulate policy and guidelines to address the economic and legal issues of these business forms.

In the past the Commission has considered developing more specific guidelines, along the lines of its *Merger guidelines,* for the competition assessment of joint ventures. However, it has decided that the interaction of the various sections of the Trade Practices Act and the breadth of potential arrangements require a case-by-case assessment within the current merger assessment framework. This view is based largely on the application of the existing substantial lessening of competition test inherent in Australian law.

Joint ventures are said to be particularly attractive to firms in highly dynamic industries, such as energy, health, information technology and financial services. Airlines use the joint venture alliance to great effect, especially in the international sphere where as few as four main alliances appear to be emerging. In Australia collaborative arrangements, such as tolling and co-production agreements, have been widely used in many traditional 'old economy' sectors.

The sectors of food processing, cement, quarrying and building materials provide examples of these types of ventures. Although many arrangements do not necessarily satisfy the Act's definition of joint ventures, they do attract attention under the Act (for example, s. 45) and this article encompasses such arrangements where the more generic joint venture terminology is used.

Alliances and collaborations in the e-commerce 'new economy' are likely to become increasingly widespread, increasing the analytical demands on the Commission. Many of these alliances are instigated by traditional companies facing increased competitive pressure. Based on Internet platforms, they are seen as a major cost-saving opportunity.

Many proponents of joint ventures have urged special treatment of such ventures by antitrust authorities, on the basis that, because of their impermanence and narrower focus, they are of less concern than mergers. Business is also using arguments based on cost pressures and competition arising from the globalisation of economies to support more lenient treatment. Joint-venture arrangements that allow rapid innovation, efficiency gains and access to distribution networks are, they argue, essential for companies to compete internationally, accessing the skills, information and capital needed to develop new products and enter otherwise difficult markets.

In its public processes to determine what, if anything, should be done to lend certainty to the treatment of joint ventures, the US noted confusion over treatment of collaborative arrangements by regulators. In submissions to the Federal Trade Commission (FTC) on global and hi-tech issues, the antitrust law as it applied to joint ventures was identified as a major issue and cited as unclear and outdated.

The EU has also considered the competition effects of joint ventures and has broadened the scope of its merger regulations to capture, at the community level, joint ventures that would not previously have been considered under that regime.

The Commission has traditionally assessed joint ventures within the same analytical framework as mergers. As with mergers, most collaborative arrangements will lift efficiency and will generally not raise any particular competition concerns. Even when the arrangement leads to greater market power and substantial lessening of competition, efficiency benefits can be considered under the authorisation and notification provisions of the Act.

The purpose of this paper is to provide an overview of joint ventures, competition issues and their treatment under the Act and to stimulate further discussion in light of their expected increased use.

Joint ventures defined

The term 'joint venture' broadly refers to cooperative arrangements between two or more firms for commercial purposes, short of a full merger. These arrangements may be purely contractual involving, for example, relatively simple information exchanges, or may involve the joint operation of existing assets. Indeed, many joint ventures establish a separate legal entity that operates as a new entrant in a particular market.

Distinctions are made on both economic and legal grounds. Some analysts refer to joint ventures as only those that establish a new entity. Others are much broader, encompassing any cooperative agreement between two or more companies linked to achieve a common commercial goal.

The US assesses per se breaches and then assesses those collaborations that do not breach the per se rules under the rule of reason. In its guidelines it identifies various types of collaborations, without needing to define the term joint venture. These include production collaborations, marketing collaborations, buying collaborations, R&D collaborations and so on. A competitor collaboration is regarded as a 'set of one or more agreements, other than merger agreements, between or among competitors to engage in economic activity, and the economic activity resulting therefrom'.

The EU defines joint ventures in terms of their effect — that is, whether they are of a concentrative or cooperative nature. However, the distinction has evolved over time and the EU has found it increasingly difficult to implement. This has led to the recent changes in EU law and extension of the reach of the merger regulations.

Joint ventures and the Trade Practices Act

Australian trade practices law defines joint ventures in s. 4J of the Act as:

> an activity in trade or commerce (i) carried on jointly by two or more persons, whether or not in partnership; or (ii) carried on by a body corporate formed by two or more persons for the purpose of ... carry(ing) on that activity jointly by ... joint control, or ... ownership of shares ...

As with definitions in the economic literature, this can apply to a wide range of commercial dealings. It effectively covers arrangements regulated by contract and those defined by incorporation. In a CCH publication the comment was made that s. 4J lifts the corporate veil to examine the motivation of the shareholders for incorporation, and thus allows greater scope for examining its competition effects. While this may well be the case at law, it is not obvious from case studies or writing on this matter that this is particularly relevant in terms of the competition assessment of a joint venture.

While an arrangement may not satisfy the definition of a joint venture under s. 4J, this does not mean that arrangements which, in practical terms, equate to a joint venture somehow escape the competition net. For example, some co-production arrangements, such as certain tolling agreements, may not satisfy s. 4J. However, they would still be subject to assessment under the Act and to the substantial lessening of competition test for any contracts, arrangements or understandings.

Rather than attract the Act to the cooperative activities, the definition provides for certain exemptions where it is satisfied.

Where there is no acquisition and consequent s. 50 activity, ss. 45 and 45A of the Act mostly deal with joint ventures and their potential anti-competitive effects. Where ancillary restraints may be a concern s. 47 may also be relevant, while s. 46 and part IIIA may also regulate joint venture conduct.

It is difficult to envisage arrangements that may not be caught by the Act when there are competition concerns. Previous work on this issue identified possible vertical arrangements that may not involve competitors in a contractual relationship and where no s. 50 acquisition has occurred. These relationships are unlikely to be a concern given the tests under the Act, as an anti-competitive outcome would probably be caught under s. 45 and its substantial lessening of competition test.

As noted, joint ventures do receive some specific treatment under the Act. Under s. 45A, contracts, arrangements or understandings that fix prices are per se illegal. While these arrangements may be authorised, the usual s. 45 competition test doesn't apply. However, under s. 45A(2) joint venture partners may enter contracts, arrangements or understandings that fix the price for supply of goods or services from the joint venture. That is, these agreements are not deemed per se illegal under s. 45A(1), although they must still meet the general s. 45 test.

Section 45A(4) also exempts joint buying and selling groups, which may include co-production arrangements. This still leaves the arrangements subject to s. 45 and the relevant competition test. CCH has commented that parties to an incorporated joint venture are not treated as favourably under s. 45(2)(c) as are parties to a contractual joint production agreement under s. 45A(2)(a) and (b). Shareholders in the joint venture company receive no immunity from s. 45A(1) when they acquire goods from the company and seek to fix the price for resupply between themselves. On the other hand, parties who have agreed to jointly produce goods may also agree to set the price at which they will individually resupply those goods. However, CCH argues that this legislative approach is more consistent with treating the incorporated joint venture as a separate legal entity.

The Act also exempts collaborative export agreements, subject to certain conditions. This exemption is found in s. 51(2)(g) for arrangements that are related solely to Australian exports provided the parties meet certain notification requirements. The provisions of any agreement must relate exclusively to export of goods from, or supply outside of, Australia.

Two more sections of the Act deal specifically with joint ventures. Section 44C regulates how part IIIA applies to partnerships and joint ventures. Its practical effect on the competition assessment is negligible. Section 90(15) relates to joint ventures and the authorisation process, where a party makes two or more applications in relation to the joint venture. Again, this section has no actual impact on competition analysis, although it is important in terms of the Commission's processes and obligations.

Competition issues and assessment

Analysis of cooperative arrangements falling under the general rubric of joint ventures is undertaken within the same framework as mergers. The competition effects will generally depend on the same factors, such as:

- identification of the relevant markets;
- industry structure and concentration;
- import competition;
- barriers to entry;
- industry dynamics; and
- supply and demand side substitutability.

The Commission's export guidelines, *Export and the Trade Practices Act,* note that, whereas in a merger competition concerns are addressed in the market(s) in which the firm will operate, joint ventures need to be considered in light of competition in all the markets in which the parties compete. This difference has not been an issue of concern for the Commission or venture parties in considering joint venture arrangements.

When assessing the effects of the joint venture on competition it is necessary to determine the level of market power and the constraints, if any, on the use of that power. A merger analysis looks at both unilateral and coordinated effects on competition in the markets being considered. In assessing the impact of a merger, the analysis rests on determining the effect of a proposal. This contrasts somewhat with s. 45, which includes a purpose test. Again, looking at case studies, the practical implication of this does not appear to be relevant.

The EU law actually assesses joint ventures in terms of their cooperative or concentrative nature. Therefore joint ventures may be assessed under the general prohibitions of article 81 or within the merger regulation of the EU. Those cooperative arrangements, deemed as 'full function' and likely to lead to higher risk of coordination between parents, are now also assessed under the merger regulations.
The EU places a great deal of emphasis on the permanence or otherwise of any joint venture in determining its assessment process.

When a joint venture does not fall within the merger regulation review and its assessment of the level of dominance, it is considered in regard to its 'object or effect (in) the prevention, restriction or distortion of competition within the common market'. Exemptions may be granted under article 81 if the parties can satisfy the Commission of its positive effect on the market and that it will provide a fair share of the joint venture benefit to consumers.

The US has now issued its *Antitrust guidelines for collaborations among competitors*. They preserve the distinction between arrangements that are considered per se illegal and those that are assessed under a rule of reason analysis. The term joint venture is avoided and thus any related need for a clear definition. The guideline assesses those collaborations that are not deemed to be per se illegal within a framework that attempts to recognise the efficiencies that may flow from a joint venture. The analysis balances the anti-competitive harm and the pro-competitive benefit to determine the overall competitive effect.

US authorities use the rule of reason if per se breaches are not evident. In doing so they consider efficiencies and pro-competitive effects that may counter potential anti-competitive impacts. In Australia the authorisation and notification provisions of the Act allow the Commission to assess efficiency and other public benefits of the arrangements.

US and EU literature has criticised antitrust authorities on the competition assessment of joint ventures. A particularly vehement argument is that regulatory authorities base their assessment on traditional, static market-power models and fail to account for dynamic gains in the future that could flow from cooperation. It is not evident that this charge is valid, or that it has any more content than many of the common criticisms aimed at regulatory authorities about merger analysis.

Market and industry dynamics are key components of competition analysis and are always considered in determining possible outcomes of a merger or joint venture.

Benefits and costs

Joint ventures (such as alliances, competitor collaborations, co-production) greatly benefit the venture parties and society more widely.

Benefits include:

- access to capital that may otherwise be out of reach of the individual partners;
- economies of scale/scope;
- realisation of synergies based on complementary skills or assets allowing for the exploitation of group expertise and technological capabilities;
- the spreading of risk;
- transaction cost economies;
- more efficient R&D, production, marketing and joint purchasing; and
- allowing companies, particularly internationally, to enter otherwise difficult markets.

While the benefits are recognised, potentially serious consequences for competition may arise from joint ventures. These include:

- reduction of competition both in the present and the future, especially in relation to possible independent entry of one or more joint venture partners; and
- the parent companies attempting to ensure that independent growth does not occur if it is likely to challenge the parents in their overall markets.

Analysis of the arrangements should therefore include an assessment of the likelihood of the joint venture partners taking various actions (that is, what would be the most likely counter factual?). For example, would the partners have entered the market separately or would one or other have left the market entirely? Answers to these questions will inform authorities about the extent of potential damage to the competitive process.

Concerns also arise about restrictive agreements that may relate to the core agreement. A joint venture agreement may affect competition between the joint venture partners, through understandings relating to other areas of their operations or information flows that allow companies to engage in collusive conduct. Information transfer is a major concern in establishing cooperative structures, especially when price and cost information flowing to potential competitors dulls the incentives to compete.

It is essential to look closely at the terms and conditions of any agreement to determine whether or not ancillary agreements flow from the core joint venture document. Spill-over effects and anti-competitive agreements that flow from the joint venture are extremely important and must be identified to assess competition outcomes. The Commission should question any agreements related to the joint venture but that seem unnecessary to achieve the stated outcome. A joint venture may allow the parties to conceal evidence of collusion thus encouraging that conduct.

As noted previously, one of the arguments for a more lenient treatment of joint ventures is that they entail less commitment than mergers. Joint ventures allow for the continued existence of the parents and potential competition from them. Joint ventures are not usually as broad as a merger allowing competitive outcomes in sectors not affected by the venture. Although joint ventures do appear to have less potential than a full merger for the creation and exercise of market power, this is not always so. The factors identified above may change the parties' incentives in their outside markets in determining their output prices.

The impact of joint ventures often varies depending on which point along the supply chain they occur. R&D proposals, for example, may be of less concern to regulators if there are no agreements downstream in production, marketing or selling. Upstream joint production where separate marketing is enforced will probably have less impact on competition.

As well as considering the range and location of the joint venture in the supply chain, the assessment should include whether a joint venture could limit competition in markets downstream. The closer the joint venture sits to product market competition the more likely the potential for anti-competitive results.

The outcome of many joint ventures in which partners continue to compete depends on the particular incentives. Tolling, for example, creates a potential loss in market sales as well as additional revenues. Incentives to compete depend on the cost structures, elasticities and resulting price and output decisions. In the extreme, the outcome may well be a market sharing arrangement that negates any competitive pressures. Analysing such arrangements may be quite difficult, especially if it hinges on such factors as determining the correct elasticities and their impact on the incentives for the venture parties.

Firms can also exchange information that reveals cost structures, production capabilities and longer-term strategic plans. These information flows may well lead to increased coordination in areas outside the actual venture.

Authorities should also be aware of the risk of joint ventures in foreclosing on potential competitors. Economies of scale, reduced costs and so forth may lead to increased barriers to entry, allowing the joint venture partners to capture higher than normal returns. Again, authorities should look at the ancillary agreements to ensure that competitors (and potential competitors) are not unduly restricted through limits to access, pricing agreements and so on.

The joint venture may also relate to an essential input highlighting access issues. A joint venture that leads to control over an essential facility or input may be able to impede competition by unnecessarily restricting rivals. In dynamic new industries it may be especially difficult to fully assess the effects until the various markets have developed further. Formal undertakings such as s. 87Bs or the authorisation process may sometimes address concerns over access and foreclosure.

Some less permanent joint ventures can be dismantled should the need arise. This implies regulatory authorities can either monitor or receive and interpret feedback from the market on the outcome of the arrangements and any changed circumstances. This may not be the reality and is a potential weakness in assessing joint ventures. Although there is an effective regime initially capable of analysing the competition effects of a joint venture, the arrangements and their impact may change over time. The developing market environment may then no longer be well served by the established joint venture.

It is difficult in the current framework to always predict the effect on the competitive environment of existing joint ventures that may have been cleared by the Commission. Possibly joint ventures assessed by the Commission need to be time limited or at least have procedures in place that allow the Commission to revisit in changed circumstances. It is difficult to envisage how this could be accomplished in the current framework, outside the authorisation process.

Tolling

The following is based on the Commission's consideration of a confidential proposal for joint tolling of manufactured product. (Tolling is an agreement to put a specified amount of raw material per period through a particular processing facility.) A substantive analysis was done and the Commission reached several conclusions about the competitive effect of tolling arrangements. Some of these effects are similar to those mentioned above for joint ventures but it is worthwhile providing a short commentary on tolling in Australia.

Theoretically it was concluded that tolling could be anti-competitive if it includes the firm charging above marginal cost for its tolling services. Of course, this implies that a serious investigation of any tolling proposal should include substantial analysis of the cost and price structure of the firms in question.

Generally, however, tolling arrangements, in particular those that include cross-tolling, have several potential impacts on the market behaviour of the firms. In the short term they may reduce the incentives for a firm to behave aggressively in a pro-competitive fashion. Subject to lack of pressure from rivals and/or potential entrants, prices are likely to rise or non-price rivalry decrease. This would arise from the symmetry between the firms and their respective profits. That is, any aggressive behaviour in the market may reduce their competitors' sales, and hence their own profits encapsulated in the tolling arrangements. A firm that is making a profit from the transaction will be less inclined to compete. In fact a dominant firm in the tolling relationship may share profits to persuade the smaller firm to refrain from competitive activity.

As in joint ventures tolling arrangements may prompt firms to communicate their strategies in advance, thereby stripping them of their effectiveness and profitability. In other words, because it would be highly unlikely that the firms could surprise one another in the market, they would be more inclined to stick with the status quo. They could also exchange information about cost, which is likely to lead to a reduction in incentives to compete.

Joint ventures and efficiency

Under Australian law, arrangements at risk of breaching the Act may be authorised, thus gaining immunity. The authorisation and notification provisions allow the Commission to effectively balance the efficiency arguments supporting joint ventures, with the competition effects.

As discussed, there may be a range of static and dynamic efficiency gains from joint ventures. These include the benefits from rationalisation and economies of scale and those associated with risk sharing and the pooling of complementary assets. If a substantial lessening of competition is likely, these gains may offset the detriment.

In assessing public benefits associated with a joint venture, the Commission examines the efficiencies obtained through the cooperative arrangements. Benefits may also be scrutinised closely and their recognition balanced against potential loss of competition, information sharing and spill-over effects that may constrain competition outcomes.

The authorisation process tends to focus on economic efficiency in terms of the competition assessment. However, other public benefits may also be highly relevant. For example, environmental issues played an important role in the Dupont/Ticor authorisation decision while broader public policy issues were considered in the assessment of the Mackay/CSR sugar joint venture. As has been suggested for mergers, business may be reluctant to propose joint ventures for authorisation, although there appears to be no evidence to support this argument. Whether or not this is currently a matter of concern to external parties is uncertain.

Conclusion

Joint ventures, whether or not they satisfy the formal definition under the Act, are of great interest to the Commission. This is particularly so in tolling and co-production arrangements underpinned by contractual agreements. The Commission's assessment may need further attention in determining the future outcomes of a joint venture as the market moves forward and in incorporating these changes into future assessment.

The Commission needs to be alive to the terms and conditions in any agreement, especially ancillary agreements that appear unnecessary to the core function of the joint venture. While competition analysis is quite complex, the effect of any relationship ultimately depends on the resulting incentives and any alteration to the existing structure of the market.

The present assessment process using the merger framework appears capable of providing good competition outcomes. Possibly many joint ventures are being created without being brought to the attention of the Commission. However, this seems unlikely given the reach of the Act, especially ss. 45 and 50, and the substantial lessening of competition test.

Thus it appears the current analytical framework is effectively serving the needs of business and competition policy.