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Joint Ventures Under India's Competition Act

A definitional problem

The treatment of joint ventures under the Act is unclear. Changes to the Act and/or implementing regulations are under discussion. It is important for both the Indian and international business communities to impress on the Indian government the need for clarity in the matter of assessment of joint ventures under the Act, and now is the time to send this message.

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Introduction

There is uncertainty as to how joint ventures should be dealt with under the Competition Act 2002, as amended (the Act). This poses significant problems for the Competition Commission of India (CCI), the business community and their advisors. The root of the problem is that the term joint venture captures a broad set of arrangements. This set includes structural changes between businesses, such as the traditional 50/50 corporate joint ventures, which may be treated as combinations (Section 5 of the Act) to traditional bilateral agreements (Section 3 of the Act) limited by time period of operation and restricted to perform one or more business functions such as research and development, production, distribution or sales.

With an eye to increasing inward investment and to spur growth of the domestic industry through competitor collaborations, it would greatly facilitate if laws governing analysis of joint ventures in India are not materially different to laws in other jurisdictions. If it is, there is the risk that it leads to businesses structuring their joint ventures in such a way that it delivers below optimum results from an economic perspective or leads to abandonment of such projects for fear of regulatory hurdles. It is understood that there are proposals to bring in amendments to the Act before bringing into force the relevant sections concerning notification of combinations (Sections 5 and 6 of the Act). It follows that now is the time for enterprises to engage with the government and the CCI to clarify, as much as possible, the application of the Act.

This article (1) briefly describes how joint ventures have been and are currently subject to the competition regime in the European Union (EU), to demonstrate that the definitional issue is not unique to India; and (2) identifies the lessons learned from the development of the EU's competition laws with the view to the Indian competition regime being able to benefit and avoid some of the issues the EU has faced in the past.

(1) JOINT VENTURES IN THE EUROPEAN UNION

(a) *Historical development*

Since 1989 a "combination" or the equivalent EU term a "concentration" has been dealt with under the Merger Regulation[1]. In relation to joint ventures, prior to 1997 a distinction was made between "concentrative" and "co-operative" joint ventures. Concentrative joint ventures fell within the scope of the Merger Regulation and co-operative joint ventures were dealt with under the EU equivalent rules to Section 3 of the Act dealing with anti-competitive agreements.

The terms "concentrative" and "co-operative" were not themselves instructive, leading the European Commission in 1990[2] and 1994[3] to issue Notices seeking to address these and other definitional issues under the legislation. The distinction was significant, both substantively and procedurally.

1 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), Official Journal L 24, 29.01.2004, p. 1-22. The Merger Regulation was first introduced in 1989 and has undergone a number of changes.

2 Commission Notice regarding the concentrative and co-operative operations under Council Regulation (EEC) No. 4064/89 on the control of concentrations between undertakings, [1990] OJ C203/10.

3 Commission Notice on the distinction between concentrative and cooperative joint ventures, [1994] OJ C 385/1.

A concentrative joint venture that met certain turnover thresholds would have to be notified prior to implementation for a consent from the European Commission. Assuming no substantive issues needed to be addressed, it would be able to benefit from a formal consent decision within a period of one month from notification. If it was a concentrative joint venture but the specified turnover thresholds were not met, then it would be subject to the competition laws of the EU Member States, to the extent that they applied to such agreements.

In contrast, for a cooperative joint venture, regardless of the turnover thresholds, a decision needed to be taken by the parties as to whether or not the agreement was within the EU's equivalent of Section 3 of the Act, and if so whether the conditions for exemption were satisfied. Prior to 2004, the parties also needed to consider the benefits or not of notification to the European Commission for acknowledgement that the agreement was not anti-competitive or that the conditions for exemption indeed applied. Obtaining a so-called negative clearance or exemption decision from the European Commission would take many months, often years, even for relatively simple matters. The result was that many businesses tried to structure their joint ventures to be "concentrative" in order to gain the benefits of a fixed regulatory timetable.

Without entering into details on the distinctions between the terms "concentrative" and "co-operative", it is sufficient to note that the distinctions were often seemingly artificial when examining the details of a particular business proposal, and it was assumed that a "concentrative" joint venture is one that is operating on its market independent of its parents. That assumption was at best artificial and often barely credible.

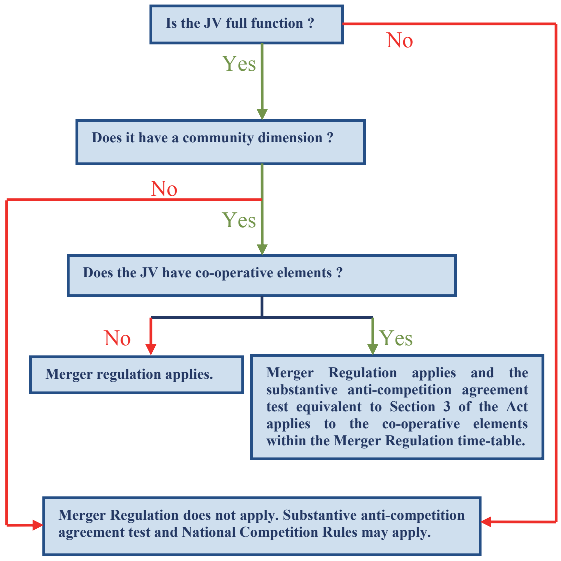
(b) The current situation

The current Merger Regulation provides that a "full function joint venture" that meets certain turnover thresholds should be notified to the European Commission. Thus joint ventures deemed co-operative previously because of the elements of coordination between the parents are now examined under the Merger Regulation, provided they satisfy the following conditions to be classified as a full function joint venture:

- existence of joint control;
- sufficient resources, assets, and financial resources to operate its business autonomously;
- existence for a sufficiently long duration as to bring about a lasting change in the structure of the market concerned.

A joint venture that does not meet the "full function" criteria set-out above will have to be analysed to determine whether or not it falls under the EU's equivalent of Section 3 of the Act relating to anti-competitive agreements. It remains the case that a joint venture that does not meet the turnover thresholds under the Merger Regulation is potentially subject to the equivalent regimes of the EU Member States. The flow-diagram illustrates this distinction in the analysis.

Even in the EU, there can be varied treatment. For example, the *BHP/Rio Tinto* transaction was proposed but then abandoned by the parties before being proposed anew as a limited joint venture. That joint venture was examined by the EU under its equivalent of Section 3 (anti-competitive agreements), whilst for example the same joint venture had to be notified to Germany under its equivalent of Section 5 (combinations). The differences in both substantive tests and timetable created significant complexity to the handling of the competition issues and process.



(2) JOINT VENTURES IN INDIA

Joint ventures may broadly be classified as having one of two forms: (i) equity/ corporate or (ii) contractual. In an equity joint venture the parent undertakings would hold voting shares in a corporate vehicle. This corporate vehicle could either be newly incorporated or may already be in existence. In distinction, a contractual joint venture does not directly centre on a corporate vehicle, but takes the form of a cooperation agreement or agreements that together define the activity of cooperation.

These definitional elements are important because a joint venture is not defined in the Act. Joint ventures are however stated to be exempt from the application of Section 3 sub-section 3 of the Act dealing with presumption of appreciable adverse effect on competition if they increase efficiency in production, supply distribution, storage, acquisition or control of goods or provision of services[4].

'Acquisition' and 'control' have been defined at Section 2(a) and at Explanation (a) to Section 5 of the Act. If we read these terminologies together along with international practices, we find that joint ventures come within the ambit of Section 3 as well as Section 5 of the Act depending on the facts and circumstances of a given transaction. However assessing whether or not a joint venture increases efficiency and so falls outside Section 3 of the Act would pose a formidable challenge. The CCI in the initial years may have to seek guidance from overseas jurisprudence. Assuming the provisions under the Act dealing with combinations (Sections 5 and 6 of the Act) are made effective without any further changes,

> Acquisition is defined as meaning "directly or indirectly, acquiring or agreeing to acquire shares, voting rights or assets of any enterprise or control over management or control over assets of any enterprise."

4 Proviso to Section 3(3) of the Act.

Section 5 Explanation(a) provides that control includes controlling the affairs or management by: (i) one or more enterprises, either jointly or singly, over another enterprise or group (ii) one or more groups, either jointly or singly, over another or group or enterprise;

a joint venture established through the acquisition of shares in an existing company would fall within the definition of a combination under Section 5 of the Act and would have to be notified if the turnover thresholds are met. If it does not meet the test it might be susceptible to challenge under Section 3 of the Act. This would be the case even though it was entered into prior to the implementation of the Act[5].

There is also potential cause for confusion as the Act stands now because it is not clear whether notification is mandatory under Section 5 of the Act if the joint venture is established by way of subscription to the shares of a newly incorporated company. This is because Section 5 of the Act concerns the acquisition of an enterprise and the definition of "an enterprise" appears to capture an existing business, not a newly created business.

Thus, there is scope for argument that a newly incorporated joint venture would not fall within the definition of a combination as it would not be an enterprise "which is or has been engaged in any activity".

"enterprise" defined (Section 2)

"a person or a department of the Government, who or which is, or has been, engaged in any activity relating to the production, storage, supply, distribution acquisition of control of articles or goods ...."

(3) THE EU LESSONS

(a) *Definitional issues*

The lesson to be drawn from the EU is that the definitional issues surrounding joint ventures can be problematic and there is no perfect solution. Because of the drafting of the original EU Merger Regulation, the EU jurisprudence revolved around concepts referred to as "concentrative" and "cooperative" joint ventures, which probably used-up more competition law resources than any other competition law subject at the time. This concentrative (combination) against cooperative (anti-competitive agreement) distinction became such a clear problem in the EU that the law was changed.

The business community would clearly prefer legal certainty, and so would likely prefer for joint ventures as far as possible to fall within Section 5. This carries the downside of having to seek prior consent if the relevant turnover thresholds are satisfied, but avoids the continual risk of challenge that exists if instead Section 3 potentially applies.

From the CCI's point of view, it is also worth noting that the likely very large volume of joint ventures that at least potentially may be within the ambit of Section 3, and so which may be subject to a complaint (referred to as "information" under the Act) by a third party, risks overloading the CCI's resources[6].

5 This follows from the judgement and order of 31.03.2010 in the Kingfisher Airlines case in The High Court of Bombay, WP No. 1785/2009.

6 This overloading of resources was the principal reason why the European Commission abandoned the ability of parties to agreements, including Section 3 style joint ventures, from being able to notify to the European Commission agreements for negative clearance or exemption.

(b) *Market share thresholds*

In the EU, despite all the caveats that are wrapped around the point, market share thresholds are considered useful for all stakeholders because they provide certainty. Thus for all Section 5 style joint ventures, market shares below 25% are generally considered a safe harbour. On the other hand a market share of 50% plus is generally considered as a serious issue.

In relation to a Section 3 joint venture, the jurisprudence of the European Commission is particularly complex, based as it is on general principles, guidance notes, case law and automatic exemptions (which again rely on market shares) and finally "non-materiality" rules also based on market shares. For the regulator and the business community the existence of market share thresholds is a choice between, on the one hand reasonable certainty of rules (and so unfairness in some cases) and, on the other hand, lack of certainty because of an effects-based analysis every time. Certainty and effects based flexibility are both attainable. In the EU for example there is a *de minimis* market share below which the European Commission would not act, but if prompted by a complainant they identify they might do so. For a particular exemption that automatically applies if specific criteria are met, the authority can withdraw the benefit of this exemption and there is guidance which describes what needs to be identified if the market share threshold is exceeded.

The CCI in a decision concerning anti-competitive agreements has recently held that an enterprise holding a market share below 17% cannot be said to be capable of 'operating independently of competitive forces' and/or 'affecting its competitors or consumers or the relevant market in its favour'[7]. Whether through decisional practice and/or formal communications, but preferably both, the CCI should be encouraged to bring out market share 'markers', so allowing business planners to understand whether or not a proposal may face regulatory challenge, and allow themselves the option of abandoning the proposal, rather than having to face the fog of war in a regulatory tussle with the CCI and then no doubt litigation.

(c) *Guidance*

In the EU the complex rules described above have become less formalistic – less rules based – and more based on guidance produced by the competition authority, which is largely based on experience. Robust rules and guidelines develop over time through an evolutionary process. Currently the CCI has insufficient decisional practice or case law on which it can issue guidance[8]. However, it can look to foreign jurisdictions to give clarity to some of the more non-controversial aspects to raise the level of regulatory certainty for the business community. To state the obvious, guidelines would help practitioners and thereby businesses understand the standards the CCI would adopt in investigation and enforcement action. It would also help the staff within the CCI to follow a uniform approach thus ensuring similar outcomes in similar cases.

7 Case No. 5/2009- Order dated 2 December 2010 of the CCI.

8 It may be noted that a lack of experience need not be a bar. The UK's Office of Fair Trading issued a consultation in October 2009 in relation to draft guidance on the application of competition law to land agreements, even though land agreements have not previously been subject to UK competition law.

Conclusion

India's competition regime will need to suit the particular business needs of its economy. However, there is benefit in ensuring that the regime is not so out of sync with the competition principles and practices around the world. The last decade has seen a lot of multinational companies investing in India, often through joint ventures, either by choice or because this is required under sector-specific FDI rules. Consequently, to the extent that uncertainties about the treatment of joint ventures can be cleared-up, this would benefit both Indian businesses and the FDI community. The EU regime had its own uncertainties in dealing with joint ventures, and addressed them. India has the ability to avoid such uncertainties, and Indian and international business communities would do well to encourage the government to address the issue.

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