ANTITRUST CLIENT BRIEFING

Jurisdictional issues in deals involving joint ventures

Review of the General Court judgment in HeidelbergCement and Schwenk Zement (T-380/17)

9 October 2020
At a Glance

Executive Summary

- The judgment provides useful jurisdictional clarifications for deals involving joint ventures (JVs) acting as an acquirer. The General Court (GC) confirms that when the true players behind the transaction are the parent companies, rather than the JV — because they did the deal valuation, negotiated the transaction structure, and determined the purchase price — the parent companies are the relevant undertakings to consider when determining whether the merger thresholds are met. This can have a significant impact on the number of merger filings required and the overall timeline of the deal.

- The GC also confirms that the European Commission (EC) can define geographic markets as catchment areas determined by transport distances between the supplier and the customer. In industries where the products cannot travel far and/or where imported goods constitute less of a constraint (e.g., because of quality issues), competition concerns in very small geographical areas can make a deal capsize.

- Finally, the GC consolidates the long-standing position of the EC that divestitures are the preferred remedy in complex cases between competitors.

The Development

- On 5 October 2020, the GC dismissed an appeal brought by HeidelbergCement and Schwenk Zement — two cement manufacturers — against an EC merger prohibition decision.

- On 5 April 2017, the EC had prohibited the acquisition of two Cemex subsidiaries by Duna-Dráva Cement (DDC), a 50/50 full-function JV between HeidelbergCement and Schwenk.
  - The EC had serious concerns that the transaction would have reduced competition in the Croatian markets for grey cement served by Cemex’s cement plants. This would have led to higher prices for cement customers.
  - The transaction would have eliminated competition between companies that were competing head-to-head for the business of cement customers and could have led to a dominant position in the markets (with a post-transaction market share of close to 70% in certain parts of the country).
  - The EC also found that DDC had been pursuing a strategy to increase sales in Croatia. The transaction would have eliminated this competition.

When One Becomes Two: Beware of Parent Companies’ Involvement in Deal Structure and Planning

- Whether a deal needs to be notified to the EC or at the national level will depend on the turnover of the undertakings concerned. In transactions where a JV acquires the target, the undertakings concerned are in principle the JV and the target. But there are exceptions.
  - When the JV is an empty shell (e.g., a special purpose vehicle), the EC will look through the JV and consider the parent companies as the undertakings concerned.
  - Likewise, the EC will consider the parent companies as the undertakings concerned in obvious circumvention scenarios, such as when a full-function JV is used as a vehicle for a transaction which is of no relevance to it and if this is obvious for all players involved. In the latter case, the undertakings concerned will be the JV’s parent companies (and not the JV itself) and the target.
• When the relevant undertakings are the parent companies and not the JV, a European filing is more likely as the parent companies alone (counting as two undertakings concerned instead of one) will be able to meet the EU jurisdictional thresholds, even if the target does not meet the thresholds.

• Identifying the undertakings concerned was one of the key aspects that the GC was asked to rule on. Notwithstanding the fact that the merging parties notified the deal to the EC following informal guidance from the EC, they argued that DDC was the undertaking concerned and not its parent companies, the consequence of which would have been that no EU filing was required.

• The GC rejected this line of argument, stating that what matters is the economic reality of the players behind the transaction. The GC agreed with the EC’s assessment that the parent companies were the true players behind the transaction and not DDC:
  o Before the kick-off meeting for the deal, HeidelbergCement took decisions regarding the implementation and composition of the steering committee overseeing the transaction process.
  o HeidelbergCement attended negotiations with the seller and prepared detailed documentation, deal valuation, and other key components of the business case.
  o HeidelbergCement negotiated the non-disclosure agreement with the seller.
  o HeidelbergCement and Schwenk discussed the potential structure of the transaction as well as the financing structure of the transaction.
  o HeidelbergCement and the seller concluded a verbal agreement on the main terms of the transaction (including the purchase price).

• The GC clarified that even if a JV is full-function, i.e., an autonomous economic entity, this does not automatically mean that it will always act independently from its shareholders — especially when it comes to strategic decisions such as its M&A activity.

• The GC concluded that the real players behind the transaction were HeidelbergCement and Schwenk and not DDC. The EC was therefore right to consider each parent company as an undertaking concerned (in addition to the target) and look at their respective turnover to determine whether the deal had an EU dimension.

When Small Is Big Enough: The Specific Case of Catchment Areas

• The EC can prohibit a transaction if it significantly impedes effective competition in a substantial part of the internal market.

• The EC found that the transaction would lead to a significant impediment of effective competition in the 250 km catchment area around Cemex’s plant in Split (Croatia). According to the merging parties, the catchment area was too small to constitute a substantial part of the internal market.

• The GC rejected this line of argument and found that the catchment area represented a surface area of more than 30,000 km² and a population of more than 2 million inhabitants. The Court of Justice has previously held that similar areas, i.e., 20,000 km² and 4 million inhabitants, constitutes a substantial part of the internal market. The GC also noted that consumption of grey cement in that catchment area compared to total consumption in the country was similar, if not higher, than the levels of consumption in other Member States, therefore showing it was not a remote area.

• The GC added that the impediment to competition does not need to be homogenously substantial throughout the catchment area. The impediment can be more substantial closer to the plant than at the extremity of the catchment area (notably because of transportation costs). However, as long as —
overall — there is a significant impediment to effective competition in the area, the transaction can be prohibited.

- This means that high levels of concentration post-transaction even in very localised areas can be a deal-breaker where transport costs are high or customers tend to source locally for reasons of security or quality of supply.

**Remedies: When Divestitures Are Best**

- It order to address the EC’s concerns during the investigation phase, the merging parties had proposed remedies whereby they would grant access to a cement terminal in southern Croatia.

- The EC had concerns that the proposed remedies would have offered only an uncertain possibility for a competitor to build up a new cement business in southern Croatia. This is because the remedies offered access to a storage facility without existing customers, brands, sales staff, or established access to cement. Any company leasing that storage facility would have had higher costs to reach customers in the Croatian markets, making it less competitive than the merging parties. This is mainly due to the transport costs to ship cement from a more remote production plant to the terminal before delivering it to final customers. The proposed remedies would also have been insufficient in scale because the terminal’s cement capacity was limited.

- The GC sided with the EC, confirming that when merging companies compete on the same markets, remedies providing a structural solution, such as selling a business unit, are the preferable option. This is because they immediately replace the weakened competition in the markets resulting from the merger. Commitments to grant access to infrastructure will only be acceptable if it is sufficiently clear there will be actual entry of new competition that will eliminate the impediment to competition.