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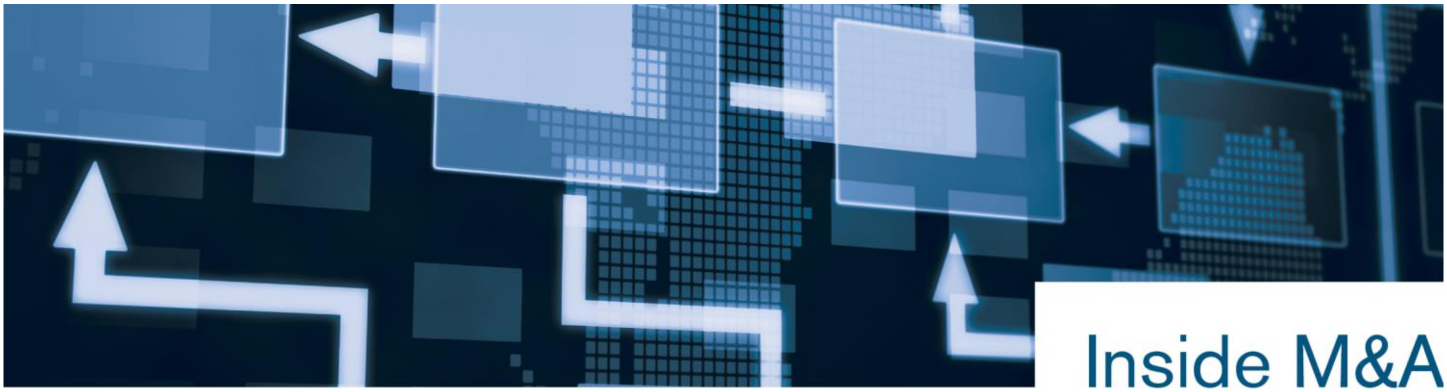
AUGUST 2016



Recent Enforcement Trends in Divestiture Packages

Carla A. R. Hine, Melanie A. Hallas

The Federal Trade Commission (FTC) and US Department of Justice's (DOJ) Antitrust Division have been actively challenging mergers and acquisitions (M&A) across a variety of industries where there is not a viable or acceptable remedy to mitigate the agencies' competitive concerns. Parties to M&A transactions that the FTC or the DOJ believe are likely to harm competition may remedy those concerns by divesting certain businesses or assets. The parties may divest the business or assets that raise anticompetitive concerns and proceed with the remainder of the transaction. Divestitures in horizontal mergers (*i.e.*, transactions between competitors) aim to maintain or replace the competition in the relevant market that might otherwise be lost as a result of the transaction.

Proposed divestitures are evaluated on the particular facts of the case and must be robust enough to present a viable competitor. Recent transactions demonstrate that the FTC and DOJ will reject divestiture proposals that the agency finds insufficient, putting the entire deal at risk for merging parties. Before proposing a remedy to the FTC or DOJ, parties should keep the following in mind: (1) in today's enforcement environment, the agencies are more demanding in seeking effective remedies; (2) the agencies are more likely to require a buyer up front, particularly if the parties seek to divest assets that are less than an entire on-going, stand-alone business, or the to-be-divested assets are at risk of deterioration pending divestiture; and (3) a buyer must be competitively and financially viable.

Proposing an Effective Divestiture Package

The DOJ and FTC are most likely to accept a divestiture package when it includes an autonomous, on-going business unit that comprises at least one party's entire business in the relevant market. As noted in the FTC's guide on *Negotiating Merger Remedies*, "The parties should be prepared to show that the business unit contains all components necessary to operate autonomously, that it has operated autonomously, that it is separable from the parent, and that the unit's buyer will be able to maintain or restore competition almost immediately."

If the proposed divestiture package is something less than a complete, autonomous and operable business unit, the parties must show that their proposed package will enable the buyer to maintain or restore competition in the market. Parties have been criticized by the agencies for proposing divestiture packages that would split complementary business lines, facilities and other dependent assets. For example, in *U.S. v. Halliburton / Baker Hughes*, the DOJ's complaint criticized the parties' proposed divestiture package because it "would separate business lines and divide facilities, intellectual property, research and development, workforces, contracts, software, data, and other assets across the world between the merged company and the buyer of the divested assets." The DOJ further explained that the proposed divestiture package lacked assets in important segments of the business that each of the major competitors in the industry possessed today and failed to include many of the assets that would be used to perform services. The DOJ rejected the parties' divestiture offer, concluding that the assets in the proposed remedy would not "replicate the competition provided by Defendants' businesses from which they would be extracted." The parties abandoned the transaction after the DOJ sued to block the deal.

Most, but Not All Transactions, Require a Buyer up Front

The agencies typically prefer and require a "buyer up front"; in other words, the parties must find an acceptable buyer for the proposed divestiture package and execute an acceptable agreement (and all necessary ancillary agreements with the buyer and third parties, if required) before the agencies accept the proposed consent order. Buyers up front have been required in many industries, including medical devices, pharmaceutical products, mirror coatings, mining equipment, industrial gases, general aviation fuel, supermarkets and other retail operations. In determining whether to require a buyer up front, the agencies evaluate the following:

- Is there a concern about whether the proposed asset package is adequate to maintain or restore competition;
- Is the asset package sufficient to attract an acceptable buyer or buyers;
- Is the pool of acceptable buyers limited because of specialized needs; and
- Is there a concern about deterioration of the assets (including human capital, good will and other intangible assets) pending divestiture?

In industries where the agencies have significant experience, and where the ownership interest is a high-value, low-risk asset that is likely to generate substantial interest from more than one potentially acceptable buyer, the agencies will not require a buyer up front. In "post-closing divestitures," the parties may enter into an agreement with the agency regarding the complete set of assets to be divested without agreeing on a particular buyer. The parties will hold separate and maintain the to-be-divested assets, but may close the part of the transaction not subject to the consent order. The order will require the parties to divest certain assets within a period of time and the potential buyer must ultimately be approved by the agencies. Recently, the FTC entered into a consent order with Energy Transfer Equity L.P. (ETE) and The Williams Company. The consent order did not require an upfront buyer and ordered ETE to divest to a Commission-approved buyer Williams' ownership interest in Gulfstream Natural Gas System, LLC, an interstate natural gas pipeline. The FTC has a variety of experience with natural gas pipeline transactions and determined that the to-be-divested asset was high-value and low-risk and would generate multiple acceptable buyers.

Buyers Must Be Competitively and Financially Viable

The agencies will look closely at any proposed buyer, and will discuss relevant issues with the potential buyer regarding the assets to be divested and the financial viability of the potential buyer. An acceptable buyer will be competitively and financially viable and have the financial capability and incentives to maintain or restore competition in the relevant market after acquiring the divested assets. A potential buyer must also have the industry know-how to operate the divested business or assets. The FTC has seen several divestitures fail when the buyer was unable to operate the business profitably. For example, when a buyer in the rental car market did not have the industry knowledge and financial capability to manage the business in a concentrated market, the divested business went bankrupt less than one year after the divestiture was complete. Additionally, a regional supermarket chain filed for bankruptcy less than one year after acquiring divested grocery stores from a large transaction that raised competitive concerns in certain states. After these divestiture-buyer failures, the agencies even more carefully scrutinize the ability of the potential buyer to successfully and competitively operate the to-be-divested assets.

Conclusion

In today's enforcement environment, and after recent experiences where buyers of divested assets faced bankruptcy shortly after acquiring the divested assets, the agencies continue to demand robust divestiture proposals. Parties should consider carefully any proposed divestiture they wish to present to the agencies, vetting potential buyers—paying particular attention to the buyer's competence and financial viability—and to the completeness of the divestiture package and its ability to independently compete in the marketplace. Merging parties should carefully evaluate the potential antitrust risk and likelihood that any competitive issues can be remedied with a divestiture before proceeding with a transaction. This analysis at the outset will inform contract negotiations and may avoid the pain of abandoning an untenable transaction.

Price Discrimination Markets Lead Antitrust Enforcers to Increased Success

Jon B. Dubrow, Ryan Leske

In the last two years, the Federal Trade Commission (FTC) and the Antitrust Division of the US Department of Justice (DOJ) brought, and won, several litigated merger cases by establishing narrow markets comprised of a subset of customers for a product. This narrow market theory, known as price discrimination market definition, allowed the agencies to allege markets in which the merging parties faced few rivals and, therefore, estimate high post-merger market shares. By their nature, price discrimination markets can lead to a challenge of a high-value deal where only a small number of the merging parties' customers are allegedly harmed. Given the increased usage by the agencies and now judicial acceptance of the theory, counsel for merging parties must consider the potential for price discrimination market definition in assessing the antitrust risks for transactions.

Price discrimination markets have gained increasing focus in each iteration of the Horizontal Merger Guidelines (Guidelines) published by the FTC and the DOJ. In § 1.12 of the 1992 Guidelines, the agencies discussed the possibility of a narrow price discrimination market in two paragraphs of a much larger section devoted to market definition. When the Guidelines were revised in 2010, the agencies decided that price discrimination markets deserved their own section.

This new Section 3 of the Guidelines addresses the possibility of price discrimination markets in detail and indicates that price discrimination markets may impact not only market definition, but also the calculation of market shares and the evaluation of competitive effects. Section 3 states that "[w]hen examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products." Essentially, the agencies are looking to determine whether the merged entity can raise prices on a select group of customers who, unlike other customers, cannot find reasonable substitutes. When the agencies find that price discrimination is possible, they will consider the impact of the merger on the targeted customers separately.

While price discrimination markets have long been part of the agency review process, this past year has seen them in a starring role in three high-profile litigations: *Sysco/US Foods*, *GE/Electrolux*, and *Staples/Office Depot*.

In *Sysco/US Foods*, the FTC challenged a proposed merger between the nation's two largest broadline foodservice distributors. On June 26, 2015, the US District Court for the District of Columbia granted the FTC's motion for preliminary injunctive relief. *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1 (D.D.C. 2015). In its opinion, the court found two relevant product markets: one for broadline foodservice distribution to local customers and a second for broadline foodservice distribution to national customers. The narrow market here was distribution to national customers because, the court found, national customers have a smaller set of options for distribution since they "typically contract with a broadline foodservice distributor that has distribution centers proximate to all (or virtually all) of their locations." *Sysco*, 113 F. Supp. 3d at 38. While the court recognized the controversy concerning price discrimination market definition, it concluded that the evidence presented supported a market for broadline foodservice distribution to national customers. Just three days after the court announced its opinion, the parties abandoned the transaction.

In *GE/Electrolux*, the DOJ filed a complaint seeking to block the transaction between two manufacturers of cooking appliances. The DOJ complaint alleged a distinction between the retail sales channel for cooking appliances and the contract sales channel for cooking appliances. Complaint at 2-3, *U.S. v. AB Electrolux*, No. 15-cv-01039 (D.D.C. July 1, 2015). Contract-channel customers include homebuilders, property managers, hotels/motels and government entities, all of whom individually negotiate the prices charged by appliance suppliers. *Id.* at 6. These customers "demand delivery directly from the appliance supplier, in significant quantities, and on a specific schedule dictated by the contract-channel purchaser," as well as a wide variety of products. *Id.* at 6-7. The DOJ alleged that contract-channel customers could be independently harmed due to their individual negotiations with suppliers and these customers could not avoid price increases due to their unique needs. *Id.* at 8-9. Thus, even though the defendants sold the same appliances to retailers, DOJ alleged that those retail sales were in a different relevant product market from contract channel sales. After four weeks of trial, General Electric walked away from the transaction and collected a $175 million termination fee.

Similarly, in *Staples/Office Depot*, the FTC challenged a merger between the nation's two largest office supplies vendors. On May 10, 2016, the District of Columbia district court granted the FTC's motion for a preliminary injunction. *FTC v. Staples, Inc.*, No. 15-2115, slip op. (D.D.C. May 10, 2016). The court concluded that the proposed merger would reduce competition in the business-to-business (B2B) contract space for office supplies sold to very large purchasers. *Id.* at 4. In this case, the FTC only alleged harm to a targeted group of customers and did not allege harm to the parties' retail customers or to smaller business customers (who had more viable supply options than the large customers). The court agreed with this narrow market definition because the large B2B customers individually negotiated contracts for their office suppliers, were more price sensitive, and required unique service from their office supplies vendors, including IT capabilities, personalized customer service, and next day and desktop delivery. *Id.* at 25-30. Less than a week after the court's decision was announced, the parties terminated the merger agreement and Staples paid Office Depot a $250 million termination fee.

With these cases establishing a strong precedent, especially in the District of Columbia district court, the antitrust agencies will continue to use price discrimination markets to shape their analysis of future mergers. Therefore, in order to determine the extent of the antitrust risk posed by a potential transaction, counsel for parties seeking to merge must determine whether a price discrimination market may exist. The Guidelines lay out two conditions that must be met for price discrimination to be feasible. The first question the agencies will ask is whether the supplier can identify a group of customers to whom prices can be increased. Examples of relevant distinctions might be large buyers versus small buyers, customers with different end uses for the same product or customers with different geographic locations. If the agencies can determine a distinct group to whom prices can be increased, they will then determine whether those targeted customers could defeat a potential post-merger price increase through arbitrage, or purchasing the good from other purchasers that are not part of the narrow price discrimination customer set and therefore would not be subject to the price increase.

The agencies will utilize this framework to assess the evidence they gather in a merger investigation. This evidence will include merging party documents and testimony, as well as the documents and testimony of the competitors and customers of the merging parties. In order to assess the antitrust risks of the deal, counsel for the merging parties should also review this evidence. Questions to keep in mind during this review include

- Has price discrimination taken place in the past;
- Does the supplier currently sub-divide its customers in any way;
- Are certain customers individually negotiating their price for the product;
- Do certain customers demand unique characteristics from a supplier that only certain competitors are capable of offering; and
- Are the merging firms only bidding against each other for a subgroup of customers?

Price discrimination markets lead to narrower markets, generally with higher market shares. This may lead to agency challenges where the merger appears lawful if markets are defined more broadly. Counsel should work with the client early in the process to determine whether an issue exists, whether it will be raise a concern for the agencies, and whether it can be fixed. Sometimes the price discrimination market may be a relatively small portion of the parties' businesses, but a relatively small problem can break up a much larger deal if the concerns cannot be easily remedied through divestiture. To aid in adequately evaluating these issues, it is important to involve expert antitrust counsel early in the transaction process.

The Concept of Full-Function Joint Venture in the EU

Jacques Buhart, Louise Aberg

In the European Union (EU), at the inception of a joint venture (JV), parent companies must determine whether the newly created structure presents a full-functionality nature, which depends on its degree of autonomy. The answer to this question will determine the legal framework applicable to it.

On the one hand, if the JV is full-function it will fall within the scope of the EU Merger Regulation (Council Regulation (EC) No 139/2004 of 20 January 2004), assuming that the turnover thresholds set out in the Regulation are met. Under these circumstances, the European Commission (EC) will assess the impact of the JV on competition on an *ex ante* basis.

On the other hand, if the JV is not full-function and takes the form of a partnership formalized by a legal structure to a large extent dependent on its parent companies, the creation of a JV will not have to be notified but the EC may operate a control *ex post*, in the light of Article 101(1) of the Treaty on the Functioning of the EU which prohibits anticompetitive agreements between undertakings. In such a context, it is up to the parent companies creating a JV to determine whether their JV is compatible with competition law rules.

The *ex post* control has the advantage of avoiding the notification process that delays the implementation of the JV. However, within that framework, companies may not obtain a clearance decision and the fate of their JV is subject to legal uncertainty. It is thus generally preferable for companies to make sure that their JV will fall within the scope of the Merger Regulation because a clearance decision is irrevocable and unlimited.

The Uncertainty of the Concept of Full-Functionality

In order to be considered full-function, a JV must operate on a market performing those functions typically carried out by undertakings operating on the same market.

In its Consolidated Jurisdictional Notice under the Merger Regulation (OJ C 95/1 (2008), the Notice), the EC has set out four criteria to ensure that a JV has sufficient autonomy towards its parent companies:

- The JV must have sufficient resources to operate independently on a market, *i.e.,* sufficient assets, staff and financial resources to perform its business on a day-to-day basis;
- The JV must carry out activities beyond one specific function for the parents, *i.e.,* it should not be limited to an activity that is essentially auxiliary to its parents and should have its own access to or presence on the market;
- The JV must have limited sale/purchase relations with the parents, *i.e.,* no significant supply or purchase agreements with its parents affecting its autonomy; and
- The JV must operate on a lasting basis, *i.e.,* during a sufficiently long period so as to change the structure of the undertakings concerned.

These criteria are clear in appearance. In practice, however, the EC adopts a pragmatic approach and case-by-case analysis in order to allow companies to benefit from a merger decision in situations where a JV would in principle not be considered as full-function. In consequence, the EC may accept to review a JV and issue a clearance decision even when the abovementioned criteria are not all fulfilled.

The analytical grid provided by the EC in its Notice is thus sometimes difficult to grasp for companies. Nonetheless, useful guidance can be found in the case law.

Guidance from the EC's Decisional Practice

Beyond the four criteria set out by the EC in its Notice to determine whether a JV is full-function or not, the EC's decisional practice provides us with useful guidance that companies should bear in mind when creating a JV.

The documentation establishing the JV. The documentation provided by the parent companies at the time of the notification of a JV has a concrete impact on the EC's assessment. In *RSB / Tenex* (case No. IV/M.904, 2 April 1997), the EC considered that the shareholders' agreement clearly showed a lack of full-function character insofar as it was written that the main purpose of the JV would be to provide services to one of the parents. In case No. COMP/M.5740 (16 June 2010), the EC advised the parties to adopt a business plan showing the future diversification of the JV's sale and purchase relations. Companies should thus bear in mind the importance of the documentation surrounding the creation of a JV (JV agreement, shareholders' agreement, business plan, *etc*.) as such documentation could help tip the balance in favor of the EC concluding that the JV is of full-function nature.

The economic context in which the JV operates. The EU courts have ruled that it is appropriate to take into account the characteristics of the market on which a JV operates in order to assess the degree of autonomy it enjoys in relation to its parent companies (see *e.g.,* judgement of the Court of first Instance of the European Communities (now the General Court of the EU), case T-87/96, 4 March 1999). In *Mannesmann / Hoesch* (case No. IV/M.222, 12 November 1992), the EC considered that a JV that was dependent on its parent companies for the supply of steel could still be considered as being full-function because vertical integration in the steel industry is normal and, to a certain extent, necessary. Market conditions may also come into play: in *EDS / Lufthansa*, the fact that the JV would rely on its parent companies during an initial startup period did not deprive the JV of its full-function nature because the market on which the JV would operate was expanding (case No. IV/M560, 11 May 1995). In *TPS* (case No. COMP/JV.57, 30 April 30 2002), the EC referred to the current situation of the pay-TV market to justify that a JV should be considered full-function. Accordingly, companies should be aware that the characteristics of the market on which their JV will operate may weigh on the EC's analysis when determining whether a JV is full-function or not and that the EC is likely to conduct a prospective analysis on such market.

The JV's access to resources. The EC has made it clear that it is not necessary for a full-function JV to actually own the resources necessary to its operation so long as they are "accessible" to the JV (see case No. COMP/JV.19, 11 August 1999). This may for example take the form of an exclusive access to the parent companies' production units (see case No. COMP/M.3506, 11 June 11 2003). In some cases, the EC may consider that the practical impossibility for a parent company to transfer the resources is not an obstacle to considering that the JV is of full-function nature (see case No. IV/M.1042, 15 January 1998). The EC has adopted a pragmatic approach in relation to intellectual property rights. It is sufficient for parent companies to grant a license to a JV (see case No. COMP/JV.44, 3 May 2000). Regard must be had to the need for parent companies to retain intellectual property rights in order to carry out their own activities on markets separate from the market on which the JV will operate (see case No. IV/M.1332, 21 December 1998).

The extent of trade relations between parent companies and the JV. According to the Notice, full-functionality requires in principle that a JV achieves more than half of its sales with third parties. However, in practice the EC often finds that a JV is full-function even when the JV's sales are mostly to its parent companies. The prospective analysis is paramount again since companies must show that sales to third parties are intended to increase. For example, the EC considered that a JV was full-function even when only 15 percent of its sales were directed to third parties in the first year of its creation, on the basis that this percentage was expected to rise to 65 percent by the third year (see case No. IV/M.1005, 15 January 1998). Regarding purchase relations with parent companies, there is no specific ratio provided in the Notice. The EC has constantly decided however that as long as transactions are operated at arm's length, on a non-exclusive basis, and without any minimum purchase commitments, a JV may be full-function even if it largely purchases supplies from its parents (see case No. COMP/M.6503, 4 July 2012).

US and EU Requirements for Pre-Merger Notification of an Acquisition of a Minority Shareholding Interest

Lionel Lesur, Bilal Sayyed, Karl E. Herrmann

In May, the Federal Trade Commission (FTC) required Hikma Pharmaceuticals PLC to divest its 23 percent interest in Unimark Remedies, Ltd. and its US marketing rights to a generic drug under manufacture by Unimark as a condition to allowing Hikma to complete its acquisition of Roxane Laboratories. The FTC was concerned that Hikma's continued holding of a 23 percent interest in Unimark after consummation of its proposed acquisition of Roxane would create the incentive and ability for Hikma to eliminate future competition between Roxane and Hikma/Unimark in the sale of generic flecainide tablets (a drug used to treat abnormally fast heart rhythms) in the United States.

The FTC's divestiture requirement was unusual but not unprecedented. The Horizontal Merger Guidelines identify three theories of competitive harm associated with an acquisition or holding of a small but significant minority interest in a competitor:

1. Minority ownership, and any associated rights, such as veto rights over the competing firm's budget or strategic decisions, or representation on its board of directors, may allow the shareholder to forestall, delay or otherwise hamper the competing firm's further development or marketing of competitive products.

2. The holder of a minority interest in a competing firm has diminished incentives to compete aggressively with the competitor firm because the holder obtains an economic benefit from the success of the competing firm through its partial ownership of that competitor.

3. The holder of a minority interest in a competing firm may have access to non-public, competitively sensitive information of the competing firm, and thus may be better able to coordinate its business decisions—such as pricing, output, or research and development efforts—with those of the competing firm, thus diminishing competition.

These theories of potential antitrust harm from minority interest acquisitions are not unique to the United States; other competition agencies, including the European Union's competition directorate, accept and apply these theories when considering the competitive impact of a firm's actual or proposed partial ownership interest in a competitor. However, the United States applies a significantly lower threshold than the European Union (and other competition agencies) for the pre-acquisition notification of an entity's acquisition of a minority, non-controlling interest in another firm.

The US HSR Act Requires the Pre-Consummation Notification of the Acquisition of Minority, Non-Controlling Interests Unless an Exemption Applies

In the United States, the Hart-Scott-Rodino Act (HSR Act) requires an acquiring person to notify the FTC and US Department of Justice (DOJ) of the acquisition of voting securities of an issuer, and observe a 30-day waiting period prior to consummating the transaction, if the acquisition is valued in excess of a specific dollar amount unless an exemption exists and all other relevant jurisdictional requirements are met.

The HSR Act has many exemptions from its reporting and waiting period requirements. One that is often applicable to acquisitions of small but significant minority ownership interests is the exemption for acquisitions of the voting securities of an issuer where the acquiring person will hold no more than 10 percent of the issuer's outstanding voting securities and the acquisition is "solely for the purpose of investment." An acquisition is solely for the purpose of investment where the acquiring person has "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." Two recent enforcement actions illustrate the very narrow conditions in which this exemption may apply.

1. The FTC and DOJ alleged that Third Point LLC, an activist hedge fund, improperly relied on the exemption when it acquired voting securities of Yahoo representing less than five percent of Yahoo's outstanding voting securities, but, at the time it was building its position "contacted … individuals to gauge their interest" in becoming the chief executive officer of Yahoo or a member of Yahoo's board of directors; "took other steps to assemble an alternative slate of board of directors for Yahoo; drafted correspondence to Yahoo to announce that [it] was prepared to join the board of Yahoo; internally deliberated the possible launch of a proxy battle for directors of Yahoo; and made public statements that they were prepared to propose a slate of directors at Yahoo's next annual meeting." In a settlement with the DOJ, Third Point agreed not to rely on the exemption when it: (1) nominated a candidate for the board of directors of an issuer; (2) proposed corporate action requiring shareholder approval with respect to an issuer; (3) solicited proxies with respect to an issuer; (4) have, or are an associate of, a controlling shareholder, directors, officer or employee who simultaneously serves as an officer or director of the issuer; (5) is a competitor of the issuer; (6) inquired of a third party of his or her interest in a management role or board seat at the issuer; (7) initiated communication with an issuer regarding board or management representation by Third Point or persons associated with or advanced by Third Point; or (8) assembled a board or management slate with respect to the issuer.

2. The DOJ alleged that VA Partners (ValueAct), an activist hedge fund, inappropriately relied on the exemption when it, among other things, acquired small but significant

interests in two competing companies (Halliburton and Baker Hughes); discussed with Halliburton management a willingness to advocate in favor of the previously announced merger of Halliburton and Baker Hughes; indicated a willingness and ability to "help develop … new terms" for a revised deal, if the merger appeared unlikely to obtain antitrust clearance; considered proposing a revised executive compensation plan to Halliburton's management; and, engaged in a strategy of "active, constructive involvement" with senior management at both Halliburton and Baker Hughes with respect to pre-closing operations of Halliburton and Baker Hughes and post-closing operations of the combined company. In a settlement with the DOJ, ValueAct agreed not to rely on the exemption if, at the time of an acquisition, it intended to, or its investment strategy identified circumstances in which it may propose to an officer or director of an issuer: (1) that the issuer merge with, acquire or sell itself to another person; (2) new or modified terms to, or an alternative to, a publicly announced merger to which the issuer is a party; or (3) changes to the issuer's corporate structure that require shareholder approval or changes regarding the pricing of the issuer's products, services, or to its production capacity or output. ValueAct also agreed to pay an $11 million civil penalty for its alleged failure to comply with the HSR Act's notification and waiting period requirements.

The Notification of Minority Interest Acquisitions under the European Union's Merger Regulations

In the European Union, shareholding interests are classified as "controlling" or "non-controlling" interests. The acquisition of a controlling interest is governed by the EU Merger Regulation. The acquisition of a non-controlling interest is not subject to pre-closing notification by the EU Merger Regulation, but can be reviewed post-consummation under the European Union's cartel and Abuse of a Dominant Position regulations). Some rare individual member states (including Germany), however, regulate the acquisition of certain "non-controlling" minority shareholding and submit them to pre-closing notification. Because the acquisition of a non-controlling interest can raise competitive concerns, the European Commission has been criticized for failing to address an "enforcement gap" for minority acquisitions of non-controlling interests. *See* Lionel Lesur and Jacques Buhart, "Minority shareholding and competition law: A necessary European reform?" *Concurrences*. November 2013.

The *Ryanair / Aer Lingus* controversy highlighted this enforcement gap. In 2006, 2008 and 2012 Ryanair launched public offerings to take over Aer Lingus. Each time, the attempts were prohibited by the European Commission. Nevertheless, Ryanair was able to build a 29.82 percent stake in Aer Lingus; because this interest was deemed "non-controlling," it was not subject to the EU's Merger Regulation. The UK Competition Commission subsequently investigated Ryanair's series of acquisitions, requiring a divestiture down to a five percent share. The UK Competition Commission noted the harm to competition caused by Ryanair owning such a large stake in its competitor.

In July 2014, the European Commission published a white paper on potential reforms to the EU Merger Regulation to address the enforcement gap. The Commission proposed that the acquisition of non-controlling minority shareholdings be brought within the notification requirements of the Merger Regulation if there was a "competitively significant link" between the target and acquirer. A competitive link may exist in two scenarios: (1) when an acquirer and target are competitors or vertically related companies; or (2) when the ownership stake either exceeds 20 percent, or is between five percent and 20 percent in circumstances where the acquired stake is combined with additional governance rights, such as a *de facto* blocking minority, the right to appoint a director or access to commercially sensitive information.

Current Status of Changes to the US and EU Merger Notification Regulations

The proposals for change in the EU Merger Regulation are not yet formalized and do not seem to be the top priority of the new competition Commissioner, but this debate remains a hot topic within the European Union. In the United States, while the HSR Act's requirement that even *de minimis* acquisitions be notified unless some exemption applies have been criticized as unnecessarily requiring the notification of tens of thousands of transactions that were not likely to violate the antitrust laws, proposals to reform the HSR Act to broaden the conditions under which the exemption for acquisitions solely for the purpose of investment will apply have not been adopted. *See* Bilal Sayyed, "A 'Sound Basis' Exists for

Revision the HSR Act’s Investment-Only Exemption,” *The Antitrust Source*. April 2013.

However, this remains an area that corporations, private equity firms and activist investors should pay close attention to because of the possibility of changes to the relevant regulations and because of the significant potential for post-acquisition challenge to the acquisition of a significant but non-controlling interest in a competitor (or in competing firms) or a firm in a downstream or upstream relationship with the acquiring firm.

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Most, but Not All Transactions, Require a Buyer up Front

The agencies typically prefer and require a "buyer up front"; in other words, the parties must find an acceptable buyer for the proposed divestiture package and execute an acceptable agreement (and all necessary ancillary agreements with the buyer and third parties, if required) before the agencies accept the proposed consent order. Buyers up front have been required in many industries, including medical devices, pharmaceutical products, mirror coatings, mining equipment, industrial gases, general aviation fuel, supermarkets and other retail operations. In determining whether to require a buyer up front, the agencies evaluate the following:

- Is there a concern about whether the proposed asset package is adequate to maintain or restore competition;
- Is the asset package sufficient to attract an acceptable buyer or buyers;
- Is the pool of acceptable buyers limited because of specialized needs; and
- Is there a concern about deterioration of the assets (including human capital, good will and other intangible assets) pending divestiture?

In industries where the agencies have significant experience, and where the ownership interest is a high-value, low-risk asset that is likely to generate substantial interest from more than one potentially acceptable buyer, the agencies will not require a buyer up front. In "post-closing divestitures," the parties may enter into an agreement with the agency regarding the complete set of assets to be divested without agreeing on a particular buyer. The parties will hold separate and maintain the to-be-divested assets, but may close the part of the transaction not subject to the consent order. The order will require the parties to divest certain assets within a period of time and the potential buyer must ultimately be approved by the agencies. Recently, the FTC entered into a consent order with Energy Transfer Equity L.P. (ETE) and The Williams Company. The consent order did not require an upfront buyer and ordered ETE to divest to a Commission-approved buyer Williams' ownership interest in Gulfstream Natural Gas System, LLC, an interstate natural gas pipeline. The FTC has a variety of experience with natural gas pipeline transactions and determined that the to-be-divested asset was high-value and low-risk and would generate multiple acceptable buyers.

Buyers Must Be Competitively and Financially Viable

The agencies will look closely at any proposed buyer, and will discuss relevant issues with the potential buyer regarding the assets to be divested and the financial viability of the potential buyer. An acceptable buyer will be competitively and financially viable and have the financial capability and incentives to maintain or restore competition in the relevant market after acquiring the divested assets. A potential buyer must also have the industry know-how to operate the divested business or assets. The FTC has seen several divestitures fail when the buyer was unable to operate the business profitably. For example, when a buyer in the rental car market did not have the industry knowledge and financial capability to manage the business in a concentrated market, the divested business went bankrupt less than one year after the divestiture was complete. Additionally, a regional supermarket chain filed for bankruptcy less than one year after acquiring divested grocery stores from a large transaction that raised competitive concerns in certain states. After these divestiture-buyer failures, the agencies even more carefully scrutinize the ability of the potential buyer to successfully and competitively operate the to-be-divested assets.

Conclusion

In today's enforcement environment, and after recent experiences where buyers of divested assets faced bankruptcy shortly after acquiring the divested assets, the agencies continue to demand robust divestiture proposals. Parties should consider carefully any proposed divestiture they wish to present to the agencies, vetting potential buyers—paying particular attention to the buyer's competence and financial viability—and to the completeness of the divestiture package and its ability to independently compete in the marketplace. Merging parties should carefully evaluate the potential antitrust risk and likelihood that any competitive issues can be remedied with a divestiture before proceeding with a transaction. This analysis at the outset will inform contract negotiations and may avoid the pain of abandoning an untenable transaction.

Price Discrimination Markets Lead Antitrust Enforcers to Increased Success

Jon B. Dubrow, Ryan Leske

In the last two years, the Federal Trade Commission (FTC) and the Antitrust Division of the US Department of Justice (DOJ) brought, and won, several litigated merger cases by establishing narrow markets comprised of a subset of customers for a product. This narrow market theory, known as price discrimination market definition, allowed the agencies to allege markets in which the merging parties faced few rivals and, therefore, estimate high post-merger market shares. By their nature, price discrimination markets can lead to a challenge of a high-value deal where only a small number of the merging parties' customers are allegedly harmed. Given the increased usage by the agencies and now judicial acceptance of the theory, counsel for merging parties must consider the potential for price discrimination market definition in assessing the antitrust risks for transactions.

Price discrimination markets have gained increasing focus in each iteration of the Horizontal Merger Guidelines (Guidelines) published by the FTC and the DOJ. In § 1.12 of the 1992 Horizontal Merger Guidelines, the agencies discussed the possibility of a narrow price discrimination market in two paragraphs of a much larger section devoted to market definition. When the Guidelines were revised in 2010, the agencies decided that price discrimination markets deserved their own section.

This new Section 3 of the Guidelines addresses the possibility of price discrimination markets in detail and indicates that price discrimination markets may impact not only market definition, but also the calculation of market shares and the evaluation of competitive effects. Section 3 states that "[w]hen examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products." Essentially, the agencies are looking to determine whether the merged entity can raise prices on a select group of customers who, unlike other customers, cannot find reasonable substitutes. When the agencies find that price discrimination is possible, they will consider the impact of the merger on the targeted customers separately.

While price discrimination markets have long been part of the agency review process, this past year has seen them in a starring role in three high-profile litigations: *Sysco/US Foods*, *GE/Electrolux*, and *Staples/Office Depot*.

In *Sysco/US Foods*, the FTC challenged a proposed merger between the nation's two largest broadline foodservice distributors. On June 26, 2015, the US District Court for the District of Columbia granted the FTC's motion for preliminary injunctive relief. *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1 (D.D.C. 2015). In its opinion, the court found two relevant product markets: one for broadline foodservice distribution to local customers and a second for broadline foodservice distribution to national customers. The narrow market here was distribution to national customers because, the court found, national customers have a smaller set of options for distribution since they "typically contract with a broadline foodservice distributor that has distribution centers proximate to all (or virtually all) of their locations." *Sysco*, 113 F. Supp. 3d at 38. While the court recognized the controversy concerning price discrimination market definition, it concluded that the evidence presented supported a market for broadline foodservice distribution to national customers. Just three days after the court announced its opinion, the parties abandoned the transaction.

In *GE/Electrolux*, the DOJ filed a complaint seeking to block the transaction between two manufacturers of cooking appliances. The DOJ complaint alleged a distinction between the retail sales channel for cooking appliances and the contract sales channel for cooking appliances. Complaint at 2-3, *United States v. AB Electrolux*, No. 15-cv-01039 (D.D.C. July 1, 2015). Contract-channel customers include homebuilders, property managers, hotels/motels and government entities, all of whom individually negotiate the prices charged by appliance suppliers. *Id.* at 6. These customers "demand delivery directly from the appliance supplier, in significant quantities, and on a specific schedule dictated by the contract-channel purchaser," as well as a wide variety of products. *Id.* at 6-7. The DOJ alleged that contract-channel customers could be independently harmed due to their individual negotiations with suppliers and these customers could not avoid price increases due to their unique needs. *Id.* at 8-9. Thus, even though the defendants sold the same appliances to retailers, DOJ alleged that those retail sales were in a different relevant product market from contract channel sales. After four weeks of trial, General Electric walked away from the transaction and collected a $175 million termination fee.

Similarly, in *Staples/Office Depot*, the FTC challenged a merger between the nation's two largest office supplies vendors. On May 10, 2016, the District of Columbia district court granted the FTC's motion for a preliminary injunction. *FTC v. Staples, Inc.*, No. 15-2115, slip op. (D.D.C. May 10, 2016). The court concluded that the proposed merger would reduce competition in the business-to-business (B2B) contract space for office supplies sold to very large purchasers. *Id.* at 4. In this case, the FTC only alleged harm to a targeted group of customers and did not allege harm to the parties' retail customers or to smaller business customers (who had more viable supply options than the large customers). The court agreed with this narrow market definition because the large B2B customers individually negotiated contracts for their office suppliers, were more price sensitive, and required unique service from their office supplies vendors, including IT capabilities, personalized customer service, and next day and desktop delivery. *Id.* at 25-30. Less than a week after the court's decision was announced, the parties terminated the merger agreement and Staples paid Office Depot a $250 million termination fee.

With these cases establishing a strong precedent, especially in the District of Columbia district court, the antitrust agencies will continue to use price discrimination markets to shape their analysis of future mergers. Therefore, in order to determine the extent of the antitrust risk posed by a potential transaction, counsel for parties seeking to merge must determine whether a price discrimination market may exist. The Merger Guidelines lay out two conditions that must be met for price discrimination to be feasible. The first question the agencies will ask is whether the supplier can identify a group of customers to whom prices can be increased. Examples of relevant distinctions might be large buyers versus small buyers, customers with different end uses for the same product or customers with different geographic locations. If the agencies can determine a distinct group to whom prices can be increased, they will then determine whether those targeted customers could defeat a potential post-merger price increase through arbitrage, or purchasing the good from other purchasers that are not part of the narrow price discrimination customer set and therefore would not be subject to the price increase.

The agencies will utilize this framework to assess the evidence they gather in a merger investigation. This evidence will include merging party documents and testimony, as well as the documents and testimony of the competitors and customers of the merging parties. In order to assess the antitrust risks of the deal, counsel for the merging parties should also review this evidence. Questions to keep in mind during this review include:

- Has price discrimination taken place in the past?
- Does the supplier currently sub-divide its customers in any way?
- Are certain customers individually negotiating their price for the product?
- Do certain customers demand unique characteristics from a supplier that only certain competitors are capable of offering?
- Are the merging firms only bidding against each other for a subgroup of customers?

Price discrimination markets lead to narrower markets, generally with higher market shares. This may lead to agency challenges where the merger appears lawful if markets are defined more broadly. Counsel should work with the client early in the process to determine whether an issue exists, whether it will be raise a concern for the agencies, and whether it can be fixed. Sometimes the price discrimination market may be a relatively small portion of the parties' businesses, but a relatively small problem can break up a much larger deal if the concerns cannot be easily remedied through divestiture. To aid in adequately evaluating these issues, it is important to involve expert antitrust counsel early in the transaction process.

The Concept of Full-Function Joint Venture in the EU

Jacques Buhart, Louise Aberg

In the European Union (EU), at the inception of a joint venture (JV), parent companies must determine whether the newly created structure presents a full-functionality nature, which depends on its degree of autonomy. The answer to this question will determine the legal framework applicable to it.

On the one hand, if the JV is full-function it will fall within the scope of the EU Merger Regulation (Council Regulation (EC) No 139/2004 of 20 January 2004), assuming that the turnover thresholds set out in the Regulation are met. Under these circumstances, the European Commission (EC) will assess the impact of the JV on competition on an *ex ante* basis.

On the other hand, if the JV is not full-function and takes the form of a partnership formalized by a legal structure to a large extent dependent on its parent companies, the creation of a JV will not have to be notified but the EC may operate a control *ex post*, in the light of Article 101(1) of the Treaty on the Functioning of the EU which prohibits anticompetitive agreements between undertakings. In such a context, it is up to the parent companies creating a JV to determine whether their JV is compatible with competition law rules.

The *ex post* control has the advantage of avoiding the notification process that delays the implementation of the JV. However, within that framework, companies may not obtain a clearance decision and the fate of their JV is subject to legal uncertainty. It is thus generally preferable for companies to make sure that their JV will fall within the scope of the Merger Regulation because a clearance decision is irrevocable and unlimited.

The Uncertainty of the Concept of Full-Functionality

In order to be considered full-function, a JV must operate on a market performing those functions typically carried out by undertakings operating on the same market.

In its Consolidated Jurisdictional Notice under the Merger Regulation (OJ C 95/1 (2008), the Notice), the EC has set out four criteria to ensure that a JV has sufficient autonomy towards its parent companies:

- The JV must have sufficient resources to operate independently on a market, *i.e.,* sufficient assets, staff and financial resources to perform its business on a day-to-day basis;
- The JV must carry out activities beyond one specific function for the parents, *i.e.,* it should not be limited to an activity that is essentially auxiliary to its parents and should have its own access to or presence on the market;
- The JV must have limited sale/purchase relations with the parents, *i.e.,* no significant supply or purchase agreements with its parents affecting its autonomy; and
- The JV must operate on a lasting basis, *i.e.,* during a sufficiently long period so as to change the structure of the undertakings concerned.

These criteria are clear in appearance. In practice, however, the EC adopts a pragmatic approach and case-by-case analysis in order to allow companies to benefit from a merger decision in situations where a JV would in principle not be considered as full-function. In consequence, the EC may accept to review a JV and issue a clearance decision even when the abovementioned criteria are not all fulfilled.

The analytical grid provided by the EC in its Notice is thus sometimes difficult to grasp for companies. Nonetheless, useful guidance can be found in the case law.

Guidance from the EC's Decisional Practice

Beyond the four criteria set out by the EC in its Notice to determine whether a JV is full-function or not, the EC's decisional practice provides us with useful guidance that companies should bear in mind when creating a JV.

The documentation establishing the JV. The documentation provided by the parent companies at the time of the notification of a JV has a concrete impact on the EC's assessment. In *RSB / Tenex* (case No. IV/M.904, 2 April 1997), the EC considered that the shareholders' agreement clearly showed a lack of full-function character insofar as it was written that the main purpose of the JV would be to provide services to one of the parents. In case No. COMP/M.5740 (16 June 2010), the EC advised the parties to adopt a business plan showing the future diversification of the JV's sale and purchase relations. Companies should thus bear in mind the importance of the documentation surrounding the creation of a JV (JV agreement, shareholders' agreement, business plan, etc.) as such documentation could help tip the balance in favor of the EC concluding that the JV is of full-function nature.

The economic context in which the JV operates. The EU courts have ruled that it is appropriate to take into account the characteristics of the market on which a JV operates in order to assess the degree of autonomy it enjoys in relation to its parent companies (see *e.g.,* judgement of the Court of first Instance of the European Communities (now the General Court of the EU), case T-87/96, 4 March 1999). In *Mannesmann / Hoesch* (case No. IV/M.222, 12 November 1992), the EC considered that a JV that was dependent on its parent companies for the supply of steel could still be considered as being full-function because vertical integration in the steel industry is normal and, to a certain extent, necessary. Market conditions may also come into play: in *EDS / Lufthansa*, the fact that the JV would rely on its parent companies during an initial startup period did not deprive the JV of its full-function nature because the market on which the JV would operate was expanding (case No. IV/M560, 11 May 1995). In *TPS* (case No. COMP/JV.57, 30 April 30 2002), the EC referred to the current situation of the pay-TV market to justify that a JV should be considered full-function. Accordingly, companies should be aware that the characteristics of the market on which their JV will operate may weigh on the EC's analysis when determining whether a JV is full-function or not and that the EC is likely to conduct a prospective analysis on such market.

The JV's access to resources. The EC has made it clear that it is not necessary for a full-function JV to actually own the resources necessary to its operation so long as they are "accessible" to the JV (see case No. COMP/JV.19, 11 August 1999). This may for example take the form of an exclusive access to the parent companies' production units (see case No. COMP/M.3506, 11 June 11 2003). In some cases, the EC may consider that the practical impossibility for a parent company to transfer the resources is not an obstacle to considering that the JV is of full-function nature (see case No. IV/M.1042, 15 January 1998). The EC has adopted a pragmatic approach in relation to intellectual property rights. It is sufficient for parent companies to grant a license to a JV (see case No. COMP/JV.44, 3 May 2000). Regard must be had to the need for parent companies to retain intellectual property rights in order to carry out their own activities on markets separate from the market on which the JV will operate (see case No. IV/M.1332, 21 December 1998).

The extent of trade relations between parent companies and the JV. According to the Notice, full-functionality requires in principle that a JV achieves more than half of its sales with third parties. However, in practice the EC often finds that a JV is full-function even when the JV's sales are mostly to its parent companies. The prospective analysis is paramount again since companies must show that sales to third parties are intended to increase. For example, the EC considered that a JV was full-function even when only 15 percent of its sales were directed to third parties in the first year of its creation, on the basis that this percentage was expected to rise to 65 percent by the third year (see case No. IV/M.1005, 15 January 1998). Regarding purchase relations with parent companies, there is no specific ratio provided in the Notice. The EC has constantly decided however that as long as transactions are operated at arm's length, on a non-exclusive basis, and without any minimum purchase commitments, a JV may be full-function even if it largely purchases supplies from its parents (see case No. COMP/M.6503, 4 July 2012).

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