The Turkish Competition Board's Approach towards the Full-Functionality of JVs Takes a Turn With Its Latest Decision Concerning The Acquisition of Sewing Machine Business of Melco

Authors: Gönenç Gürkaynak, Esq., Ebru İnce, Çiğdem G. Okkaoğlu, Cansu İnce and Evgeniya Deveci, ELIG Gürkaynak Attorneys-at-Law

Introduction

The Turkish Competition Board ("***Board***") published its latest reasoned decision concerning the acquisition of joint control over the industrial sewing machine business ("***Target Business***") of Mitsubishi Electric Corporation ("***Melco***") by Juki Corporation ("***Juki***") and Melco[1]. The Board evaluated that the transaction concerning the acquisition of joint control by Juki over the Target Business, which was under the sole control of Melco pre-transaction, is an "acquisition" within the meaning of Article 7 of Law No. 4054 on the Protection of Competition ("***Law No. 4054***") and granted its unconditional approval.

The decision is of significance as it shows the most up-to-date approach adopted by the Board regarding the establishment of a joint venture over an existing undertaking or a part of it to which a turnover can be attributed. In this decision, the Board evaluated whether the requirement of full-functionality is to be taken into consideration or not in case of establishment of a non-greenfield joint venture.

The decision brings a new approach by establishing that as long as a structural change as a result of the transaction is observed in the market, the Board would not seek the full-functionality

[1] Board's decision dated 19.01.2022 and numbered 22-04/57-26 (the "**Decision**").

criterion. With this approach, the reach of full-functionality criterion has been substantially narrowed down to the transactions concerning the establishment of green-field joint ventures.

<u>The Board's Decision</u>

<u>General Overview of the Transaction</u>

The transaction concerned the acquisition of joint control over the (i) industrial sewing machine business of Melco and (ii) industrial sewing machine business of Melco's wholly-owned subsidiary Meiryo Technica Corporation ("***Meiryo***") by Juki and Melco. Accordingly, the Target Business was carved out into a newly established company Juki TechnoSolutions Corporation ("***Juki Techno***") as a wholly-owned subsidiary of Meiryo. The transaction was planned to be implemented through a share purchase agreement signed between Juki and Meiryo. According to the share purchase agreement, Meiryo undertook to sell a number of shares of Juki Techno to Melco and subsequently sell the remaining shares to Juki. Accordingly, Juki would be the majority shareholder whereas Melco would have certain veto rights at the closing of the Transaction.

Post-transaction, Melco (and its subsidiary Meiryo), by carving-out its industrial sewing machine into Juki TechnoSolutions, would exit the market and the joint venture (i.e. Juki TechnoSolutions) would start to supply exclusively to Juki.

While analysing the product markets, the Board indicated that in Turkey, Juki operates through its distributors in industrial sewing machines, household sewing machines and the electronic assembly systems whereas Melco is active in lockstitch sewing machines business.

To provide a better view into the relevant sector, the Board proceeded with analysing the market and delivered its further assessments stating that the industrial sewing machines market, which is the market in which both Juki and Melco are active in, can be sub-segmented into lockstitch sewing machines and chainstitch sewing machines. The Board concluded from a demand-side perspective that the lockstitch sewing machines and chainstitch sewing machines constitute two separate markets based on their differentiating appearances, features, functions and stretching abilities. From a supply-side perspective, the Board resolved that the lockstitch sewing machines and chainstitch sewing machines have different sewing structures and therefore comprise of different machine parts. The Board also considered the production lines of both businesses and concluded that lockstitch sewing machines and chainstitch sewing machines should be considered different products and therefore constitute independent product markets.

The Board refrained from delivering an exact product market definition and therefore left such definition open while delivering its examinations considering the business in which Juki Techno is planned to be active in post-transaction (i.e. the lockstitch sewing machines business).

Although the Board assessed that there is a horizontal overlap in parties' worldwide activities, the Board highlighted that after the transaction Melco will not be active in sewing machine business as it would be carved out and transferred to Juki Techno. The Board also indicated that Juki Techno will not be active in Turkey, post-transaction.

The Board concluded that parties' activities do not overlap vertically or horizontally and therefore the transaction does not give rise to any affected markets in Turkey as Melco does not generate an income in lockstitch sewing machines. Consequently the Board determined that the established joint venture will not be active in Turkey also considering the fact that Juki Techno will exclusively supply its products to Juki post-transaction.

<u>The Board's Assessment on Joint Control and Full-Functionality</u>

As per Article 5 of Communiqué Concerning the Mergers and Acquisitions Calling for the Authorization of the Competition Board No. 2010/4 ("***Communiqué No. 2010/4***"), in order for an establishment of a joint venture to be considered an acquisition within the meaning of the Communiqué No. 2010/4, two conditions should be met together: (i) joint control over an undertaking and (ii) full-functionality of the joint venture. Accordingly the Board has made its analysis regarding these two conditions.

The Board's Analysis Concerning Joint Control

The Board assessed that Juki Techno will be jointly controlled by Melco and Juki post-transaction as Juki will hold the majority of votes in the general meeting, as per the shareholders agreement signed between Juki and Melco, whereas Melco will have veto rights over certain strategic decisions, specifically the appointment and dismissal of the senior management, and over the annual business plan, in the general meeting.

By emphasizing the abovementioned points, the Board concluded that the requirement of joint control is fulfilled in terms of the transaction subject to the Decision.

The Board's Analysis Concerning Full Functionality

As per the Guidelines on Cases Considered as a Merger or an Acquisition and the Concept of Control ("***Guidelines on the Concept of Control***"), to be fully functional, a joint venture should, (i) have sufficient resources to operate independently on the market, (ii) make activities beyond one specific function for the parents, (iii) be independent from the parent companies in sale and purchase activities and (iv) operate on a lasting basis.

Paragraph 78 of the Guidelines on the Concept of Control sets forth an exception to this rule. Accordingly, even if a joint venture will not be fully functional after the transaction, such transaction may constitute a concentration as per the Law No. 4054 so long as it leads to a structural change in the market. As per the wording of this article, this exception is applicable only in case of a transaction involving "several undertakings acquiring joint control of another undertaking or parts of another undertaking". Even though this wording is not crystal clear, the general interpretation so far has required all of the previous controlling shareholder(s) of the existing undertaking over which the joint control would be established to exit the picture with the notified acquisition[2].

[2] See the Board's following decisions: *Volkswagen / Trinity / Pon Holdings / Europcar* (25.11.2021, 21-57/803-398); *CMLKK/Lodos* (14.08.2018; 18-28/468-227); all available only in Turkish.

On the other hand, in its *ISC/TDR Capital/Aggreko* decision[3] while referring to the exception set forth in Paragraph 78[4] of the Guidelines on the Concept of Control, the Board left out the condition of acquiring joint control from third parties and therefore provided an interpretation of Paragraph 78 as this exception would be applicable in every case where a joint venture is established over an already active undertaking pre-transaction, even when the joint control is not acquired by third parties[5]. Based on the foregoing, until the Decision at hand, the above-mentioned interpretation in the *ISC/ TDR Capital/Aggreko* decision was rather isolated from the Board's general approach towards full-functionality of joint ventures.

With the Decision at hand, the Board reinforced this approach by concluding that if a joint venture is established on a business unit which generates turnover pre-transaction (i.e. joint venture is established over an existing undertaking or a part of it to which a turnover can be attributed, a non-greenfield joint venture), the full-functionality condition will not be sought regardless of the parties acquiring the joint control, by relying on the resulting structural change in the market following the transaction. Respective and the most significant section of the Decision reads as follows; "*it is set that the acquisition of joint control will result in a structural change in the market even in the cases where the acquired undertaking is not considered full-functional after the transaction, as planned by the acquirer undertakings.*"

Even though Melco, the sole controller of the Target Business before the transaction, remains as a controlling parent post-transaction (i.e. the transaction does not involve an acquisition of joint control from third parties), the Board concluded that the transaction will lead to structural change in the market and is therefore notifiable, considering that after the commencement of the

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[3] The Board's *ISC / TDR Capital / Aggreko* decision (29.04.2021, 21-24/290-132).

[4] Paragraph 78 of the of the Guidelines on the Concept of Control reads as follows: *"Article 5(1) provides that the case where control is acquired by one or more undertakings of the whole or parts of another undertaking is a transaction under the scope of article 7 of the Act. Therefore, the acquisition of another undertaking by several undertakings to establish joint control constitutes a concentration under the Act. As in the case of the acquisition of sole control of an undertaking, the acquisition of joint control will lead to a structural change in the market even if, according to the plans of the acquiring undertakings, the acquired undertaking would no longer be considered full-function after the transaction. Thus, a transaction involving several undertakings acquiring joint control of whole or parts of another undertaking, fulfilling the criteria set out in paragraph 17, from third parties will constitute a concentration within the scope of the Act according to the Communiqué without it being necessary to consider the full-functionality criterion."*

[5] Ibid. para. 7.

transaction, Melco will exit the lockstitch sewing machines market and Juki Techno will supply products exclusively to Juki. In other words, the Board ruled that in cases where a joint venture is established over the whole or a part of an active undertaking, such transaction will be deemed notifiable regardless of the full functionality of the joint venture and who acquires joint control. With this decision, it is understood that while implementing Paragraph 78 of the Guidelines on the Concept of Control, the Board will focus on whether the transaction will create a structural change in the market rather than detecting whether joint control is acquired by completely new [third] parties. This indicates that the Board will do away with literal interpretation of Paragraph 78 and focus on whether the transaction would lead to a structural change in the market.

As a result, despite the fact that the joint venture is deemed not fully-functional (as it is stated in the Decision that post-transaction the joint venture will exclusively supply its products to Juki), the transaction is considered to be subject to notification within the meaning of the Communiqué No. 2010/4.

Consequently the Decision demonstrates the Board's current approach towards the full-functionality criterion while non-greenfield joint ventures are being reviewed.

Conclusion

As thoroughly explained above, the Board's recent Decision is of the utmost importance as it demonstrates the Board's current approach in the interpretation of Paragraph 78 of the Guidelines on the Concept of Control. The Decision indicates that the Board will focus on structural change when conveying its decision regarding whether the transaction concerning the establishment of a joint venture constitutes an acquisition or not. And thereby, the requirement of full-functionality criterion would be sought as an absolute prerequisite only for the establishment of green field joint ventures. Accordingly, the establishment of a joint venture over an active undertaking or part of would be considered a concentration within the meaning of Law No. 4054, regardless of it being fully functional or not. Therefore, with this decision, it is understood that while implementing Paragraph 78 of the Guidelines on the Concept of Control, the Board will focus on whether the transaction will create a structural change in the market rather than detecting whether joint control is acquired by completely new [third] parties. This indicates that the Board will do away with literal interpretation of Paragraph 78 and focus on whether the transaction would lead to a structural change in the market.

Article Contact: Gönenç Gürkaynak, Esq. E-mail: gonenc.gurkaynak@elig.com

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