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Ancillary Status of Non-Compete Obligations in the Cement Sector: Issues of Geographic Scope

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In Turkey, non-complete obligations may be evaluated under the scope of "agreements that restrict competition" or "abusive conducts of dominant undertakings" (Article 4 and 6 of Law No. 4054 on Protection of Competition ("Law No. 4054"), akin to Article 101 and 102 of TFEU, respectively). However, non-compete obligations in mergers and acquisitions[1] may benefit from the "ancillary restraints" regime. The Turkish Competition Board ("Board"), along with the other competition law authorities, allows certain non-compete obligations to be imposed on the sellers in in merger and acquisitions to the extent they are (i) directly related to and (ii) necessary for the implementation of the concentration.

This article investigates the geographical scope of non-compete obligations under the "ancillary restraints" regime[2] based on the Board's precedents in cement sector.

- *Purpose: Implementation of the Concentration*

The ancillary restraints regime seeks to enable the full effectiveness of a concentration. Non-compete obligations on the seller aim to ensure that the buyer acquires the target with its whole value, including non-material values such as its commercial reputation, know-how and customer portfolio.[3],[4] A non-compete obligation on the seller that helps fully implementing the projected outcome of the transaction must be limited in its (i) duration, (ii) geographical scope and (iii) subject matter in order to be deemed as directly related to and necessary for the implementation of the concentration.[5]

- *Direct Relevancy and Necessity Criteria*

Equivalent to the Commission Notice on restrictions directly related and necessary to concentrations ("Notice"), the Turkish Competition Authority published the Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions ("Guidelines") (approved by the Board on May 3, 2011 and last amended on March 26, 2013). According to the Notice and the Guidelines, a restrictive clause is considered to be ancillary to the concentration only if the clause is directly relevant to the concentration and necessary for its implementation. The restrictive clause should be imposed on the seller from

[1] Article 7 of Law No. 4054.
[2] Peter Roth QC, Vivien Rose, European Community Law of Competition, Sixth Edition, Oxford University Press, [2008], p. 793, para. 263.
[3] Peter Roth QC, Vivien Rose, European Community Law of Competition, Sixth Edition, Oxford University Press, [2008], p. 795, para. 8.266.
[4] Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions, para 52.
[5] Ancillary Restraints Notice, para. 14.

an economic perspective, in order to achieve smooth transition to the post-transaction structure.[6]

The necessity criterion requires an assessment on whether the restriction is necessary for the implementation of the concentration and whether without such restriction the concentration would result in uncertainty and cost increase.[7] Ancillary restriction must just satisfy the proportionality test and must not go beyond what is necessary for the concentration.[8] In order to determine whether a non-compete obligation is necessary to preserve or to transfer value in a particular transaction, its scope and term would also be assessed.[9]

The non-compete restrictions must also be limited in their duration, geographical scope and subject matter in order to be deemed as directly related to and necessary for the implementation of the concentration (and thus as an ancillary restraint).

- *Geographical Scope of Ancillary Restraints*

According to the Notice, geographical field of the application should not exceed what the implementation of the concentration reasonably requires.[10] To this end, the geographical scope of a non-compete restriction must be limited to the area in which the seller (target) has offered the contract good/s or service/s before the transfer.[11] That geographical scope could be extended to territories which the seller (target) was about to enter at the time of the transaction, provided that it had already invested in preparation for this move.[12]

Turkish Competition Board's analysis and position on ancillary restraints in cement sector:

Prior to the enforcement of Communiqué No. 2010/4 on Mergers and Acquisition Requiring the Approval of the Competition Board ("Communiqué No. 2010/4"), the non-compete clauses were notified by the transaction parties and assessed by the Board. Therefore, the Board's reasoned decisions prior to the enforcement of Communiqué No. 2010/4 provide a better insight into the assessment of non-compete clauses and the extent to which such restraints could be accepted as ancillary to the concentration.

Recent reasoned decisions of the Board do not contain any analysis regarding ancillary restraints as upon the enforcement of Communiqué No. 2010/4, the "ancillary restraint" status of a non-compete obligation became an issue of self-assessment. The Board does not devote a separate part of its decision to the ancillary status of any restraint brought with the transaction.[13] Therefore, the parties have to engage in self-assessment and evaluate whether the non-compete obligation could be considered as ancillary to the merger transaction. However, the transaction parties have to beware of the risk that in case they fail to correctly analyze the non-compete obligation, the agreement might fall under Article 4 (agreement,

[6] Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions, para 50.
[7] Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions, para 51.
[8] F. Enrique Gonzalez Diaz, *Notion of Ancillary Restraints Under EC Competition Law*, Fordham International Law Journal, Volume 19, Issue 3, Article 8 [1995], p. 957.
[9] Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions, para 51.
[10] Ancillary Restraints Notice, para. 14.
[11] Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions, para 56.
[12] Guidelines on Undertakings Concerned, Turnover and Ancillary Restraints in Mergers and Acquisitions, para 56.
[13] Article 13 of Communiqué No. 2010/4.

concerted practice) or Article 6 (abuse of dominant position) of Law No. 4054 and might create the risk of competition law violence, even in cases where the transaction was granted unconditional approval. As per Article 13 of Communiqué No. 2010/4, the Board's approval decision of the concentration will be deemed to cover only the directly related and necessary extent of restraints in competition brought by the transaction (e.g. non-compete, non-solicitation, confidentiality, etc.).

- Particularity of Cement and Ready-to-Mix Concrete Cases

The Board's precedents indicate that the geographical scope of an ancillary restraint should be limited geographically to the "area of operation of the seller (target) before the transaction and its natural sales hinterland".[14] As provided, the geographical scope of an ancillary restraint should be "directly related to and necessary for implementation of the concentration". In the assessment of non-compete obligations in merger and acquisition cases, the Board acknowledges the geographical scope as the locations of the target's facilities, where the target's activities are being carried out, and its natural sales hinterland as reasonable and necessary for the implementation of the transaction.

Some products or services may easily be provided nation-wide or even worldwide, whereas some other products, because of their material nature, may not easily reach distant territories. Cement and ready-mix-concrete set examples to the latter. In cement cases, relevant geographic market is mostly defined based on the locations of the target's facilities since the material nature of cement only allows undertakings to transport the product within a certain range, mostly in a 250-300 km radius. Similarly, ready to mix concrete freeze quickly; therefore, it can be transported approximately within a 50 km radius.

- Region-wide Restriction

Many precedents of the Board in cement cases indicate that a non-compete obligation limited with the region where the target has activities could be considered as directly related and necessary. For example, in *Baştaş/Aktaş*[15], the Board assessed the non-compete obligation on the sellers not to directly or indirectly conduct businesses competing with the target in Marmara Region for two years. The target operates in a few cities in Marmara Region and Central Anatolia Region. The parties stated that such a restriction is directly related to and necessary for the acquirer to create its own know-how and customer portfolio and penetrate into the Marmara Region. The Board concluded that the non-compete obligation does not restrict competition more than it is necessary in terms of the subject matter, person, geographical scope and term.[16]

In *Limak/Şanlıurfa Madencilik*[17], the transaction agreement between the parties states that each seller agrees that neither itself nor any of its subsidiaries would conduct or invest in a new cement business, which would directly compete with the target in the southeastern region of Turkey, for 2 years as of the closing of the transaction. The target was active in five cities in the Southeastern Anatolia Region. In this decision, the scope of the non-compete clause

[14] *Cementeire Aldo Barbetti/Çimko*, 07-37/398-157, 3.5.2007.
[15] *Baştaş/Aktaş*, 07-53/595-201, 20.6.2007.
[16] Also see. *Denizli/CRH*, 15.2.2007, 07-14/117-36.
[17] *Limak/Şanlıurfa Madencilik*, 07-89/1130-441, 6.12.2007.

was wider than the relevant geographic market definition. The Board considered the non-compete obligation as an ancillary restraint.

In *Çimentaş/Elazığ Cement*[18], the Board assessed the non-compete clause by referring to the necessity criterion. It stated that the main purpose for the non-compete clause is to provide the buyer with the transfer of intangible assets, such as commercial reputation and know-how, to their fullest value. For this purpose, the buyer needs to be protected against the seller's competition until the buyer creates its own customer portfolio and fully benefits from the know-how acquired from the seller. The decision does not particularly contain any discussion regarding the geographical scope even though it was limited on the basis of region rather than cities. To this end, decision includes that Elazığ Cement's (target) main hinterlands regionally are East and Southeastern Anatolia Regions and partially East Black Sea Region. Decision provides a list of the cities in these regions where the target has activities, which amounts to 14 cities. The transaction agreement defines the geographical scope of the non-compete obligation as the "eastern part of Turkey".

Narrower Geographical Restriction

In addition to the approach explained above, there are some cases where the Board acknowledges city and even county based non-compete obligations separately for cement and ready to mix concrete relevant products.

In *Çimpor/Yibitaş*[19], the share purchase agreement between the parties includes a non-compete clause which prevents the sellers and its affiliates to conduct directly or indirectly any continuous manufacturing or commercial operation in relation to the full range of cement, ready to mix concrete and aggregate in the markets in which YLOAÇ (target) provides services (18 cities mostly in Black Sea and Central Anatolia Regions). The Board considered the foregoing clause as ancillary restraint.[20]

In *Cimpor Yibitaş/Tokbetsan*[21], according to the transaction agreement, the sellers would not be directly or indirectly conducting a ready to mix concrete business within the 30 km radius around the transferred facility for three years as of the date that Cimpor (acquirer) starts its operations in the said facility. The target's hinterland was a single city in Turkey where the acquirer has no ready to mix concrete activity. Since the restriction was found to have its effects only on the target, the non-compete obligation was assessed as an ancillary restraint.

In *Lafarge/OYAK*[22], a Phase II decision, the geographical scope of the non-compete clause was found to be too comprehensive in the agreement. Therefore, the parties amended the agreement and limited the scope of the non-compete obligation on the basis of geographical market for each contract good (grey cement, ready-mixed concrete, and aggregate) as cities or as areas narrower than the cities (i.e. Asian side of Istanbul). Accordingly, the Board defined the possible widest areas for the non-compete obligation as "Kocaeli, Sakarya, Bolu, Düzce" for cement, "İstanbul, Kocaeli, Tekirdağ, Balıkesir" for ready to mix concrete and "Marmara

[18] *Çimentaş/Elazığ Çimento*, 06-63/850-242, 14.9.2006.
[19] *Çimpor/Yibitaş*, 07-14/118-37, 15.2.2007.
[20] Also See *ÇimSA/BHB*, 2.6.2008, 08-36/481-169.
[21] *Cimpor Yibitaş/Tokbetsan*, 27.6.2008, 08-41/557-210.
[22] *Lafarge/OYAK*, 09-56/1338-341, 18.11.2009.

region" for aggregate. The narrower geographical scope definitions of the parties for non-compete obligation was acceptable by the Board. In its assessment on the necessity criterion, the Board took notice of the fact that the acquirer was a new entrant in the market whereas the seller was a longstanding player. In order to protect the acquirer against the seller's competition in the relevant market for contract good/s or service/s, and considering the know-how transfer, the Board found the non-compete clause to be necessary, thus an ancillary restraint.

Conclusion

Assessment of a non-compete obligation as a "restrictive agreement" or as an "abusive conduct of a dominant undertaking" significantly differs from its assessment as an ancillary part of a concentration. Ancillary restraints should be directly related to and necessary for the implementation of the concentration; however, to the extent it exceeds this proportionality, it could be considered as an agreement among undertakings which has as its object or effect or likely effect to the directly or indirectly prevent, distort or restrict competition or as an abuse of dominant position in case the relevant undertakings are in a dominant position in the market. As seen above, and also referred to in the Notice and the Guideline, so long as a non-compete obligation is directly related and necessary for the implementation of the concentration, the pro-competitive effect or the object of such restriction could be left outside of this assessment. [23] In an event, the prudent approach would be to limit the geographical scope of the non-compete obligation to the location/region where the target carries out its activities and to its natural hinterland when engaging in self-assessment for the ancillary restraints.

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[23] Ariel Ezrachi, *EU Competition Law: An Analytical Guide to the Leading Cases,* [2014], s. 110.