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Antitrust Liability For Joint Ventures

The Lessons of Texaco Inc. v. Dagher

By W. Stephen Smith

The term "joint venture" encompasses a wide range of business combinations, some of which are simply contractual agreements between independent parties, others of which involve the creation of new entities through consolidation, and some of which involve both integration and contractual agreements. Because joint ventures comprise such a diverse array of business structures, they often defy easy characterization for antitrust purposes: Is a venture best viewed as a merger? A price-fixing agreement? Something in between? This characterization problem contributed to significant confusion in the courts over the proper scope of antitrust liability for joint ventures.

At one time, courts routinely declared unlawful a variety of joint ventures, many of which were plainly pro-competitive. The Supreme Court's decision in *Texaco, Inc. v. Dagher*, 126 S.Ct. 1276 (2006), clarifies the application of the antitrust laws to joint ventures, and narrows the scope of potential liability for these types of business combinations.

Key Implications

Although the *Dagher* case involved the oil industry, the legal principles it establishes apply to joint ventures in all industries. The Supreme Court's decision provides parties to joint ventures with increased confidence that:

- The *per se* rule of antitrust liability will apply to joint ventures only in rare cases — *eg*, when the venture itself is a "sham" for unlawful price-fixing or market division.
- A joint venture's core activities, such as setting the price of the venture's products, will not be subject to antitrust challenge.
- Antitrust liability for restraints on non-venture activities, such as competition from the joint venture's parent companies, will remain subject to review under the "ancillary restraints doctrine."

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Background

The *Dagher* case involved a joint venture between Texaco and Shell Oil that consolidated the companies' West Coast refining operations as well as the marketing and sale of gasoline to downstream purchasers such as service stations. Although the joint venture, known as Equilon, fully consolidated the refining and sales functions of its parents, the venture continued to market its refined gasoline products under both the Texaco and Shell Oil brands. Texaco and Shell Oil, through their joint control over the venture, agreed that Equilon would market and sell both brands of gasoline at the same price.

Federal and State Review of The Joint Venture

The creation of the joint venture was subject to a lengthy review by the Federal Trade Commission under the Hart-Scott-Rodino Act, and by the Attorneys General of California, Hawaii, Oregon and Washington. The FTC "evaluated the formation of the [joint venture] as if [it were] a complete merger of the downstream operations of Texaco and Shell." *See, Chevron Corporation/Texaco Inc.*, File No. 011-0011, Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson (Sept. 7, 2001) (available at www.ftc.gov/os/2001/12/atstat.htm).

None of the governmental agencies viewed the joint venture's price-setting policies as separate restraints of trade or expressed concerns about the lawfulness of these policies. This analytical approach is consistent with the federal agencies' subsequently promulgated Antitrust Guidelines for Collaboration Among Competitors, which state that fully integrated joint ventures of sufficient duration should be evaluated as mergers under the standards of Section 7 of the Clayton Act, — *ie*, under a "rule of reason" style of analysis. U.S. Dep't of Justice & Federal Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors, Section 1.3 (2000) (Competitor Collaboration Guidelines), reprinted in 4 Trade Reg. Rep. (CCH) ¶13,161.

The federal and state review culminated in consent orders, pursuant to which the joint venture parties divested a package of assets, including refinery, terminal and service station operations. The Director of the FTC's Bureau of Competition declared the settlement "a victory for motorists" that "preserves competition and assures that consumers will not pay more for gasoline and other petroleum products, especially on the West Coast." Shell/Texaco/Star, File No. 971-0026, Press Release (Dec. 19, 1997) (available at www.ftc.gov/opa/1997/12/shell.htm).

The Ninth Circuit Decision

After the joint venture began operations, 23,000 service station owners brought a class action suit alleging that Texaco and Shell Oil violated the Sherman Act's *per se* rule against price fixing by agreeing that the Equilon joint venture would sell Texaco and Shell Oil brands of gasoline at the same price. In their complaint, the plaintiffs "disclaimed any reliance on the traditional 'rule of reason' test, instead resting their entire claim on either the *per se* rule or a 'quick look' theory of liability." *Dagher v. Saudi Refining, Inc.*, 369 F.3d 1108, 1121 (9th Cir. 2004) (citations omitted). The district court denied the defendants' motion to dismiss, but granted their motion for summary judgment on the ground that the lawfulness of the joint ventures is properly analyzed under the rule of reason.

A panel of the Ninth Circuit reversed, over a dissent by Judge Fernandez, concluding that there was a triable issue of fact as to whether the joint venture's pricing practices should be evaluated under the *per se* rule. Writing for the majority, Judge Reinhardt held:

> The proper inquiry for a *per se* analysis of price fixing is not simply whether the joint venture itself is anticompetitive. Nor is the relevant question simply whether the defendants intended to destroy competition. … Rather, if the answer to those questions is negative, we must decide whether the defendants' conduct — setting one, unified price for both the Texaco and Shell brands of gasoline instead of setting each brand's price independently on the basis of normal market factors — is reasonably necessary to further the legitimate aims of the joint venture.
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> *Id*. at 1121.

Put simply, the majority regarded the joint venture's price formation rules as collateral restraints, *ie*, conduct that could be subject to *per se* condemnation under the ancillary restraints doctrine. *Id*. at 1124 ("the defendants have failed to produce sufficient evidence demonstrating that their price fixing scheme was ancillary rather than naked").

Applying this doctrine, the majority found that the defendants "failed to offer any explanation of how their unified pricing of the distinct Texaco and Shell brands served to further the venture's legitimate efforts to produce better products or capitalize on efficiencies." 369 F.3d at 1122. It rejected the defendants' argument that integrated joint ventures inherently have the right to set the prices of the venture's products on the grounds that: 1) there is at least a triable issue of fact as to whether the decision to charge a common price for the two brands in this case was made by the joint venture entities or, instead, by Texaco and Shell when they formed the joint venture; and 2) such an argument, if accepted, would permit "any number of companies [to] create joint ventures as fronts for price-fixing." *Id*. at 1124.

THE SUPREME COURT DECISION

The Supreme Court unanimously reversed the Ninth Circuit's holding that the joint venture's pricing conduct was potentially subject to *per se* liability.

First, the Court emphasized that it "presumptively applies rule of reason analysis" to any alleged violation of the Sherman Act. 126 S. Ct. at 1279. The *per se* rule of antitrust liability, in contrast, applies only to narrow classes of conduct that "are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality." *Id*. (quoting *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978)). Under the rule of reason, courts weigh the potential pro-competitive effects of the challenged conduct against its potential anti-competitive effects, taking into consideration factors such as: the market power of the parties in the relevant market, the business justification for the conduct, and the likely competitive effects of the conduct.

Second, the Court observed that Equilon was a legitimate joint venture in which Shell and Texaco pooled their resources and shared the risks and profits from the joint venture's activities. It noted that the courts below had found "a voluminous record documenting the economic justifications" for the joint venture, including synergies and efficiencies that would result in hundreds of millions of dollars of cost savings, and that the plaintiffs had not challenged the formation of Equilon as anticompetitive. *Id*. at 1280 n.1.

Third, the Court held that "the pricing policy challenged here amounts to little more than price setting by a single entity," and that while this conduct "may be price fixing in a literal sense, it is not price fixing in the antitrust sense." *Id*. at 1280. This conclusion was "confirmed by [plaintiffs'] apparent concession that there would be no *per se* liability had Equilon simply chosen to sell its gasoline under a single brand." *Id*.

Finally, the Court rejected the Ninth Circuit's application of the "ancillary restraints doctrine" to Equilon's pricing conduct, explaining that this doctrine applies only to competitive restraints on "nonventure activities" — *eg*, restraints on competition from the joint venture's parent companies. *Id*. at 1280-81. The doctrine has no application where the business practice being challenged "involves the core activity of the joint venture itself," in this case the pricing of the goods sold by the venture. *Id*. at 1281.

ANALYSIS AND IMPLICATIONS

The Ninth Circuit's decision was a substantial detour from the path of modern-era joint venture law and, as such, created significant legal uncertainty for both existing joint ventures and businesses planning future joint ventures. The court of appeals fell victim to the same confusion over the proper characterization of joint venture activities that had plagued earlier joint venture decisions. Specifically, it confused a joint venture's price-setting activity — which is core joint venture conduct — with horizontal price-fixing by independent competitors. This confusion led the court to apply the wrong legal standard in reaching its judgment.

Modern courts have recognized that a fully integrated joint venture like Equilon is, in substance, a merger of the parties' competing business lines, the very purpose of which is to end competition between the parties so as to enable them to compete more vigorously against other rivals. *See also,* Competitor Collaboration Guidelines, Section 1.3. When a court or agency evaluates the lawfulness of a legitimate horizontal joint venture under the rule of reason, it is necessarily evaluating whether the consolidation of the price-setting functions of former rivals lessens competition. *Id*. at Example 1. Given that there was no dispute that Equilon was legitimate joint venture, and no challenge to the lawfulness of the venture itself, then the elimination of competition inherent in the venture should have been deemed *per se* lawful. A decision by Equilon to charge the same price for Shell and Texaco gasoline is no different than a decision by Hewlett-Packard to charge the same price for HP and Compaq brand computers. As the leading antitrust treatise explains: "once a venture is judged to have been lawful at its inception and currently, decisions that do not affect the behavior of the participants in their nonventure business should generally be regarded as those of a single entity rather than the parents' daily conspiracy." 7 Phillip Areeda & Herbert Hoven-kamp, *Antitrust Law*, ¶1478, at 325.

The Supreme Court's decision in *Dagher* is important for two reasons. First, the decision eliminated the legal uncertainty facing companies engaged in joint venture activity by correcting the confusion the Ninth Circuit's decision had created. Second, the decision placed joint venture law back on its proper path, emphasizing that the rule of reason presumptively applies to joint venture conduct, and that the *per se* rule should never be applied "where the economic impact of [a joint venture's] practices is not immediately obvious." 126 S. Ct. at 1279.

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