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US Antitrust Law & Joint Ventures

Antitrust and Anti-Competition Issues in Joint Ventures and Other Competitor Collaborations

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- Interdisciplinary capabilities
- Durable and effective joint venture and alliance structures
- Within a jurisdiction and across borders
- Multiple industries
- The spectrum of the JV/SA continuum:
  - **Planning and Strategy**
  - **Formation and Negotiation**
  - **Business Building**
  - **Governance and Disputes**
  - **Exits and Monetizations**

Speakers

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What are the Antitrust Laws?

- Antitrust law is the law of business competition
- U.S. economy is based on a <u>Competitive Model</u>
  - More Competition → More Products/Services → Lower Prices → Better Service and Quality
  - Monopoly → Fewer Products/Services → Higher Prices → Poorer Service and Quality

What is the Purpose of the Antitrust Laws?

- To Protect and Promote Process of Competition *Not* to Protect Specific Competitors
- Antitrust Laws Seek to Protect Consumer Welfare:
  - To Stop Activity That Will Raise Prices or Diminish the Quantity or Quality of Products and Services

Key Terms & Concepts

- Market Power: Ability of a firm (or cartel) to increase the price of products/services above competitive level, reduce quality or innovation below competitive level, or exclude competition, i.e., the ability to cause anticompetitive effects.
  - *Generally, Market Power is required to demonstrate an antitrust violation.*
  - Market Power (typically) = High Market Share.
- Procompetitive: Activity that enhances a firm's ability to lower prices, increase output (e.g., a joint venture that creates new products or efficiencies).

Key Terms & Concepts

- Per Se: Activities deemed to lack any serious pro-competitive effects; that almost always lead to higher prices and reduced output; are considered automatically illegal, i.e., they cannot be justified as a matter of law.

- Rule of Reason: Most transactions and conduct (except collusion) are analyzed to see whether the procompetitive benefits outweigh the anticompetitive effects.

SPECIFIC PROHIBITIONS

Specific Prohibitions Sherman Act § 1 (Per Se Violations)

- Generally, an agreement between competitors that involves:
  - Price-fixing or output reduction
  - Bid-rigging
  - Market allocation ("you take east, I'll take west")
  - Customer allocation ("you take Customer A, I'll take Customer B")
  - Group boycotts (e.g., competitors agree not to deal with certain customers or suppliers)
  - Tying (where seller uses a "tying" product in which it has market power to force a customer to purchase a "tied" product on which seller faces competition)

- Per se violations can result in criminal liability.

Specific Prohibitions
Sherman Act § 1 (Rule of Reason Analysis)

- Rule of Reason arrangements include:
  - Mergers
  - Legitimate joint ventures
  - Exclusive dealing/contracts
  - Bundled or multiproduct discounts
  - Tying (where the seller does not have market power in tying product)
  - Vertical agreements on price
- Even traditionally *per se violations* (e.g., competitor agreement on price) may be judged under the Rule of Reason if they are <u>ancillary</u> (reasonably necessary) to a procompetitive endeavor (i.e., an agreement on price that enables a JV between competitors to offer a new product).

Specific Prohibitions
Exclusive Dealing (Rule of Reason Analysis)

- Exclusive Dealing: can result, for example, when a seller agrees to give a customer a large discount in return for a customer agreeing not to purchase the particular product or service from another supplier.
- In general such contracts are considered procompetitive – can result in efficiencies from selling customer larger volumes; certainty of sales volume can lead to lower prices.
  - Can raise anticompetitive concerns if the contract in question forecloses a substantial portion of the market to competitors of the exclusive dealer.
  - Generally, if the contract forecloses less than 30-40% of the market, it is unlikely to be anticompetitive. See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 46 (O'Connor, J. concurring) (agreement foreclosing 30% or less of relevant market unlikely to be held anticompetitive); *United States v. Microsoft*, 253 F.3d 34, 70 (D.C. Cir.), *cert. denied*, 122 S.Ct. 350 (2001) (40% or greater foreclosure can sustain Section 1 claim that exclusive contract is anticompetitive).

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Specific Prohibitions
Exclusive Dealing (Rule of Reason Analysis)

- Exclusive Dealing (cont.): Degree of foreclosure exceeds 40% - need to look more closely at other factors, including:
  - Length of contract (1 year or less generally not an issue; more than 3 years more likely to be an issue).
  - Whether remaining sales available in market are sufficient to enable competitors to remain in business, maintain competitive cost structure, or prevent the exclusive dealer from raising prices or reducing other competitive efforts (*e.g.*, service, quality, innovation).
  - Ease with which existing competitors can expand, or new competitors can enter if the exclusive dealer raised prices (in general, will expansion or new entry take place within one to two years of the price increase at sufficient scale to defeat increase).
  - Procompetitive justifications for exclusive, see, *e.g.*, *Beltone Electronics Corp.*, 100 F.T.C. 68, 204 (1982).

Specific Prohibitions Sherman Act § 2

- Prohibits **Monopolization**, **Attempted Monopolization**, and **Conspiracies to Monopolize** a market by anticompetitive means.
  - Having a monopoly alone is NOT a violation.
  - Focus is on the *unlawful* use of market power by a Single Firm.
  - Monopolization Requires Significant Market Share (e.g., 70%).
  - Attempted Monopolization – can be found at 50%.
  - Exclusive contracts, bundled rebates, predatory (below cost) pricing, abuse of a patent, or other behavior that tends to exclude or disadvantage competitors may be used by a party to monopolize or attempt to monopolize a market.
  - Activities legal when done by a party without monopoly power may violate Section 2 if done by a monopolist (e.g., exclusive contract).
  - Formation of a JV between significant competitors could be viewed as a conspiracy to monopolize.

Specific Prohibitions
Clayton Act § 7

- Prohibits Mergers, Acquisitions and Joint Ventures that *May* Substantially Lessen Competition or *Tend* to Create a Monopoly.
  - Section 7 is Forward Looking and Predictive – looks beyond the immediate impact of the merger (incipiency standard).
  - Does not require an actual lessening of competition but rather a conclusion that the merger is *likely* to raise prices, restrict output, or *lead to* anticompetitive exclusionary conduct.
- Primary Concern = Market Power – Will the Combination Tend to Create or Facilitate Exercise of Market Power?
- Look to See if Combination Will Lead to Higher Prices or Restricted Output.

Specific Prohibitions
Clayton Act § 3

- Regulates certain activities that tend to substantially lessen competition or lead to the creation of a monopoly including:
  - Exclusive Dealing,
  - Tying, and
  - Reciprocal Dealing.

Specific Prohibitions
Federal Trade Commission Act § 5

- The FTC Act is broader than the Sherman Act or the Clayton Act.
- It prohibits <u>Unfair Competition and Deceptive Practices</u>.
  - FTC may use Section 5 to pursue conduct not covered by these other statutes (e.g., *Intel* – attacking broad range of pricing and contracting practices under Section 5 arguably to avoid Section 2 requirements).

Specific Prohibitions State Antitrust Laws

- <u>All</u> of the states have passed their own competition laws. Most state antitrust laws mirror the Sherman Act.
- <u>Many</u> states also have unfair competition laws that are similar to the FTC Act.
- It is possible for a company to have *simultaneous* federal and state antitrust enforcement actions/investigations pending against it.

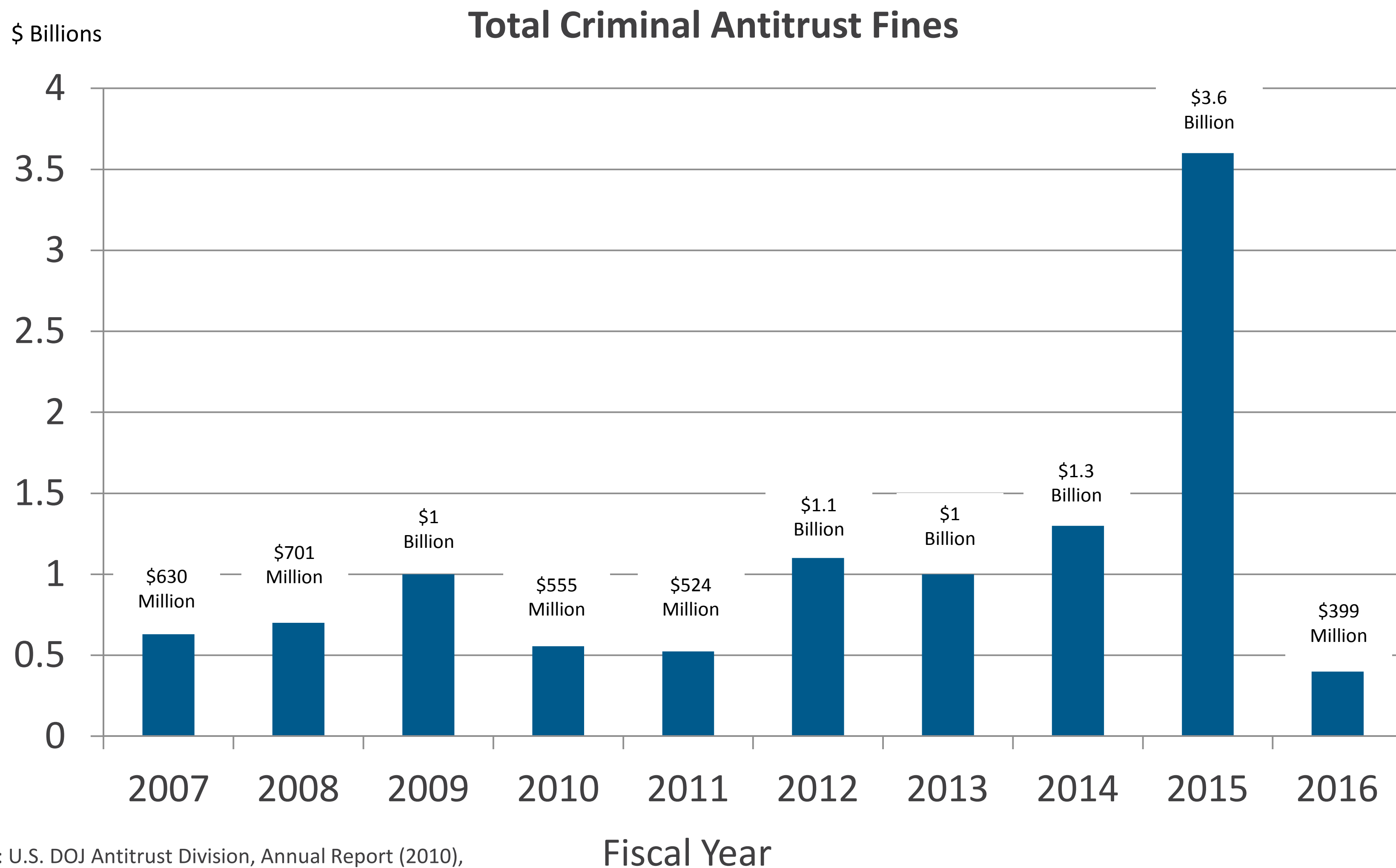
Antitrust Enforcement: The Basics

- The laws are enforced by:
  - Federal Agencies
    - Department of Justice (Antitrust Division)
      - Enforces Sherman Act, Clayton Act
      - Criminal and Civil Enforcement Authority
    - Federal Trade Commission
      - Enforces Sherman Act, Clayton Act, FTC Act
      - Civil Enforcement only
    - Department of Justice responsible for criminal enforcement
  - State Attorney Generals
  - Private Individuals/Entities, Class Actions

Antitrust Enforcement: The Basics

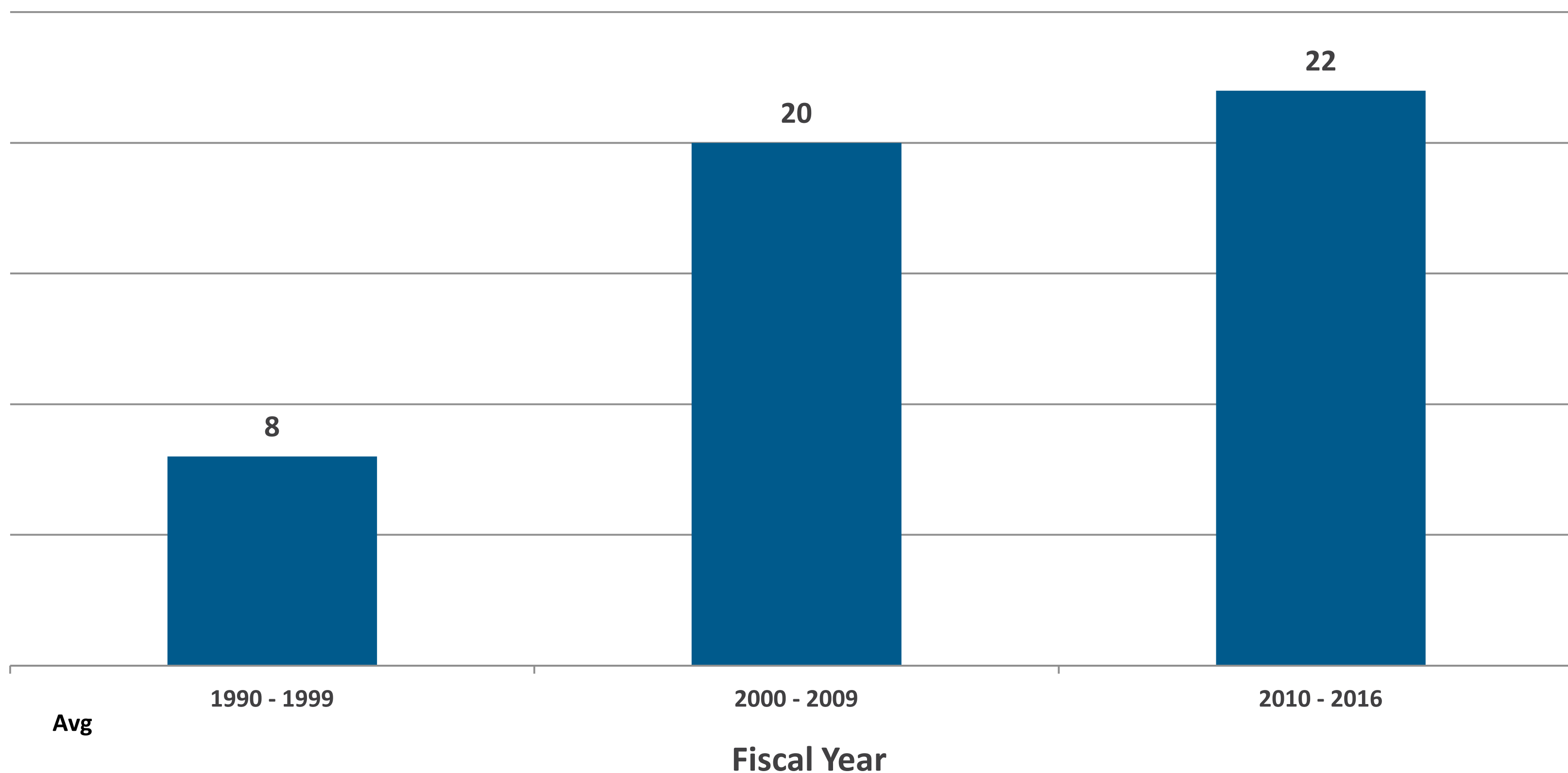
- Violations of federal antitrust laws may lead to *significant criminal fines*, *jail time*, *civil damages* and *injunctive relief* against businesses and individuals:
  - Entities: fines up to $100M, or double the gain/loss
  - Individuals: up to 10 years in prison and fines up to $1M, or double the gain/loss
  - Private Lawsuits: civil actions -- treble damages (triple the amount of actual or compensatory damages), plus attorneys' fees and costs
- Fines, damages and injunctive relief under state law, too.
- Injunctive relief may place significant restrictions on business operations (e.g., require asset divestitures, licensing IP; prohibit exclusive contracts; prohibit joint venture partners from exchanging price-related information).

Antitrust Enforcement: At a Glance



Source: U.S. DOJ Antitrust Division, Annual Report (2010), https://www.justice.gov/atr/criminal-enforcement-fine-jail-charts

Antitrust Enforcement: At a Glance



Source: U.S. DOJ Antitrust Division, Annual Report (2010), https://www.justice.gov/atr/criminal-enforcement-fine-jail-charts

JOINT VENTURES

Antitrust Guidelines for Collaboration Among Competitors (FTC & DOJ)

- A joint report by federal antitrust enforcement agencies providing guidance on how competitors may collaborate without running afoul of the antitrust laws
- The report provides guidance regarding different forms of collaboration and illustrative examples
- **http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf**

Analysis of Joint Ventures

Is the JV “Legitimate”?

- Key Question = Are there *procompetitive effects* or is the collaboration a *cartel* capable of engaging in *per se* illegal activity?
- Examples of procompetitive effects:
  - Enables the creation of a new product;
  - Reduction in price for market buyers;
  - Measurable efficiencies the parties could not achieve on their own.
- *See* DOJ/FTC Guidelines, Example 6 (p. 31): A collaboration between two software competitors combines their complimentary capabilities in order to produce a better word processing program that neither could offer alone.
- *Compare with* DOJ/FTC Guidelines, Example 7 (p. 32): Where parties agree on product component without integration of activities, the collaboration does not create any procompetitive benefits but, instead, is a sham to increase the participating companies’ profits.

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Analysis of Joint Ventures

Does Operation of the JV Violate the Antitrust Laws?

- Key Question = Will the JV partners set prices, allocate markets, agree not to compete, etc., *without* a legitimate procompetitive purpose?
- Such agreements may be a *per se* violation unless they are ancillary (reasonably necessary) to accomplish the JV's procompetitive purposes, in which case the rule of reason applies.
- *See* DOJ/FTC Guidelines, Example 4 (p. 31): Two software companies, both struggling to market and distribute their products, form a JV with pricing control to jointly accomplish those goals. The anticompetitive risk (price-fixing) is balanced against the JV's procompetitive effects (increased products).
- *Compare with* DOJ/FTC Guidelines, Example 5 (pp. 31-32): Two car part manufacturers agree to refrain from competing in alternating years. This arrangement is likely *per se* illegal.

Analysis of Joint Ventures

Will formation of the JV confer market power?

- Key Questions = (1) Will the JV confer *market power* on the participating companies that would not exist otherwise? (2) If so, do the JV's procompetitive benefits *outweigh* the potential anticompetitive risks?
- According to the FTC/DOJ Guidelines, Sec. 3.33: market power increases the ability of the companies to create anticompetitive effects but…
  - "Market share and market concentration provide only a starting point for evaluating the competitive effect" of a joint venture.
  - A *main factor* in the agencies' evaluation of a JV is whether "anticompetitive harm is more or less likely."

Analysis of Joint Ventures

What Factors are Relevant as to the Effect on Competition?

- Key Question = to the extent the JV parties will continue to compete with each other outside the JV, will factors such as the terms of the *JV agreement*, structure of the *JV management*, and *access to competitive information* restrain such competition?
- Agencies consider whether competing JV parties will have the incentive and ability to compete based on factors such as:
  - Does the agreement permit such competition?
  - Do parties retain independent control of assets required to compete?
  - Do parties retain control of the JV's and their own decision making on competitive issues?
  - What is the likelihood of anticompetitive information sharing?

JOINT VENTURE GOVERNMENT ENFORCEMENT AND RECENT CASE LAW

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Enforcement Agency Guidance:
General Motors – Toyota (FTC 1984)

- FACTS: GM and Toyota production joint venture for new subcompact cars
- CONCERNS: That GM would stop independent development of small cars and that JV would result in exchanges of sensitive competitive information not required to achieve the JV's benefits
- BENEFITS: Increased consumer choice of cars and reduced production costs to GM
- AGENCY RESPONSE: JV permitted to proceed, but FTC order prohibited exchanges of information between the parties regarding:
  - The prices of cars or component parts produced by the JV that the parties would market separately, other than for the purpose of a supplier-customer relationship, and
  - Sale or production forecasts, and costs for non-JV products

Enforcement Agency Guidance: *Boeing – Lockheed Martin (FTC 2007)*

- FACTS: Boeing and Lockheed Martin formed a joint venture to combine the only two suppliers to the U.S. government for heavy to medium launch services to put space vehicles into orbit. The government purchased the space vehicles from three principal suppliers – Boeing, Lockheed Martin and Northrop Grumman.
- CONCERNS: The JV would create a monopoly, and that information exchanges would reduce competition between the JV parties and other JV customers.
- BENEFITS: The DOD supported the JV as critical to national security.
- AGENCY RESPONSE: The FTC order required that in providing its services:
  - The JV not provide preferential terms to Boeing and Lockheed Martin, and
  - Limit information exchange of price, cost and proprietary information between Boeing and Lockheed Martin, and between each of these parties and the JV, unless strictly necessary for JV success.
  - Information exchange limited to Boeing and Lockheed Martin personnel who were not involved in competing with these suppliers for government programs.
  - JV must maintain separate information systems, appropriate firewalls and a separate office location.
  - The JV also was required to design a compliance program and provide training to ensure restrictions on information exchanges were observed.

Recent Case Law:
American Needle, Inc. v. NFL (2010)

- Challenge to NFLP's grant of exclusive apparel license to Reebok
- NFL argued it should be regarded as a "single entity" and not subject to Section 1 of the Sherman Act
- U.S. Supreme Court held that NFL's licensing activity was not categorically beyond the reach of Section 1, but rather was subject to analysis under the Rule of Reason
- Crucial facts: NFLP was <u>controlled</u> by a group of would-be <u>competitors</u> and deprived the marketplace of independent centers of economic decision-making

JOINT VENTURE ANTITRUST GUIDELINES

JV Guidelines

Information Exchange

- Restrict information exchange between **JV partners** on business where the companies compete regarding (a) pricing, (b) output and (c) market strategy.
- Restrict information exchange between **JV partners** to the extent the JV continues to compete with one or both parties.
- Specific questions re guidelines?

JV Guidelines

Information Exchange

- Guidelines Section 2.1 – **JV partners** Commercially Sensitive Information can't be shared with JV directors, officers, managers, employees, etc.
  - Example – Can the same Company salesperson also handle JV sales? To the same customers?
  - Example – Customer asks JV salesperson to provide comparison of JV price to price of Partner 1 – can salesperson provide this? What if salesperson is Partner 1 employee? Should customer be told to get estimate from someone else at Partner 1?
- Guidelines Section 3.1 – **JV partners** employees working for JV can't provide JV Commercially Sensitive Information to either company directors, officers, etc.
  - Example – Customer asks JV salesperson (Partner 1 employee) if Partner 1 will reduce price to meet the JV price. Can the salesperson ask Partner 1 to do this? Go to Partner 1 officer or director who also is a JV officer or director?

JV Guidelines
Market Power

- Formation of the JV *adds* a new option to the market.
- But JV will reduce competition if **JV partners** are no longer independent competing options in market.
- The guidelines (Section 4.2) provide: once a customer decides it does not want to use the JV, **JV partners** *must compete* for business as if no JV existed.