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presents

Avoiding Antitrust Violations in Competitor Collaborations

Lessons From FTC/DOJ Enforcement Actions and Litigation

A Live 90-Minute Audio Conference with Interactive Q&A

Today's panel features:

MJ Moltenbrey, Partner, **Freshfields Bruckhaus Deringer**, Washington, D.C.

Philip C. Larson, Partner, **Hogan & Hartson**, Washington, D.C.

Gary P. Zanfagna, Associate General Counsel and Chief Antitrust Counsel, **Honeywell International Inc**., Morristown, N.J.

Thursday, May 28, 2009

The conference begins at:

1 pm Eastern
12 pm Central
11 am Mountain
10 am Pacific

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Avoiding Antitrust Liability in Competitor Collaborations

MJ Moltenbrey

May 28, 2009

Joint Ventures Defined

- Any collaborative activity in which firms pool assets and share risks in pursuit of a common objective, but remain independent economic actors
  - Joint Purchasing
  - Production
  - Marketing and sales
  - R&D
  - New products or services
- Structure of Joint Ventures
  - New economic entity
  - Contractual arrangement

Antitrust review/challenges to joint ventures involving competitors

- Applicable Statutes
  - Sherman Act § 1 and § 2
  - FTC Act § 5
  - Clayton Act § 7 and § 7A (Hart-Scott- Rodino Act)
- Standards of Review
  - Per Se
  - Rule of Reason
  - Quick Look
  - Merger Analysis
- Guidance
  - DOJ and FTC, Antitrust Guidelines for Collaborations Among Competitors (2000)(***Competitor Collaboration Guidelines***)
    - http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf
  - DOJ and FTC, Statements of Antitrust Enforcement Policy in Health Care (1996)(***Health Care Guidelines***)
    - http://www.usdoj.gov/atr/public/guidelines/1791.pdf

Economic Integration – How much is enough?

- Must be sufficient “efficiency-enhancing integration of economic activity”
  - Joint venture performs some business activity with potential to increase efficiency
    - Combine assets to obtain “plausible” efficiencies that parties wouldn’t achieve absent the JV
    - Increase participants ability or incentive to compete
  - Agreements that involve, price, output, customer allocation, etc must be “reasonably related to the integration and reasonably necessary to achieve its procompetitive benefits”
  - Mere coordination of price, output, customers, under the label “joint venture” not sufficient to avoid *per se* condemnation
    - *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951)
    - *Arizona v. Maricopa County Medical Soc’y*, 457 US 332 (1982)
    - Competitor Collaboration Guidelines, § 3.2
- Where JV eliminates all competition among participants in a market for an extended period of time, it may be analyzed as if it were a merger
    - *United States v. Ivaco, Inc*., 704 F. Supp. 1409 (W.D. Mich. 1989)

Potential Procompetitive Benefits of the Joint Venture

- New product or service?
  - *Broadcast Music v. CBS*, 441 U.S. 1 (1979)
- Combine complimentary assets (including technology or know-how)?
- Economies of scale or scope?
- Risk Sharing?
- Network benefits?

Potential Anticompetitive Effects

- Rule of Reason Analysis
  - Nature and purpose of the agreement
  - Market structure and concentration
  - Actual effects
- On balance, does the joint venture increase the ability or incentive of participants to raise price or reduce output, quality, service or innovation?
  - Does the JV restrict or eliminate competition among participants with a significant share of the market?
  - Does it facilitate coordination on activities outside the scope of the joint ventures, e.g., through the exchange of information?
  - Does it facilitate exclusion, e.g., because the JV participants can deny rivals access to an essential network?

Ancillary or Collateral Restraints

- Is the restraint “naked” or “ancillary”?
  - Even where a Joint Venture itself is legitimate, it may include specific restraints on the JV participants, or between the JV itself and its parents, that in the absence of the JV would be *per se* illegal
- Is it “subordinate and collateral to” the legitimate aspects of the JV?
  - — *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 224 (D.C. Cir. 1986)
- Is it reasonably related and no broader than necessary to effectuate the JV’s legitimate objectives?
  - — *SCFC ILC, Inc. v. Visa U.S.A., Inc*., 36 F.3rd 958, 970 (10th Cir. 1994)
- Is it a “core activity” of a legitimate JV?
  - — *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006).
- Is it “reasonably related to the integration and reasonably necessary to achieve its procompetitive benefits”?
  - – Competitor Collaboration Guidelines, § 3.2

Competitor Collaboration Guidelines

- An agreement needn't be "essential" in order to be reasonably necessary
- If there are practical, significantly less restrictive means available to achieve the restraints objective, it is not ancillary
- The agencies will not search for a mere theoretically less restrictive alternative that is not practical given the business realities
- Agencies will undertake a limited factual inquiry to evaluate claims that restraints are ancillary

Specific Cases - *Texaco, Inc. v. Dagher,* 547 U.S. 1 (2006)

- JV between Texaco and Shell combining all gasoline refining and distribution assets in the western US
  - Brands previously sold at different price points
  - Post JV prices were set by the JV
- Plaintiff retail station owners alleged that setting a common price for Shell and Texaco branded gasoline was per se illegal
- Supreme Court:
  - The decision to set prices within the joint venture – rather than have each partner to the venture set a price for its brand of gasoline separately – could not be a *per se* violation
  - The venture's decision about how to price and sell its output was the act of a single entity (but not based on *Copperweld*) as the
  - The conduct at issue was central to the operation of the venture, therefore the ancillary restraints doctrine is not applicable

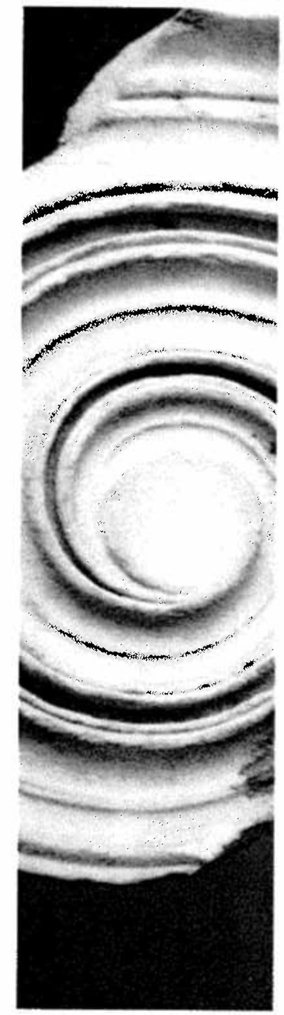
Specific Cases – *United States v. Visa, et al.*, 344 F.3d 229 (2d Cir. 2003

- Visa and MasterCard established as joint ventures among banks to create a payment card network
- Both joint ventures adopted rules that excluded banks from becoming members if they issued cards on certain "competing" card networks (American Express and Discover)
- DOJ challenged the rules as anticompetitive under a "rule of reason" theory
- D. Ct. found that the defendants had market power, that the rules restricted competition among payment card networks, and that the defendants had failed to show that the rules served a legitimate procompetitive purpose
- 2nd Circuit affirms
  - Rule of reason analysis
  - Gov't proved market power and anticompetitive effects
  - Defendants failed to show that the anticompetitive effects of their exclusionary rules are outweighed by procompetitive benefits

Specific Cases – *The Three Tenors*

- PolyGram Holding, Inc., FTC Docket No. 9298 (July 24, 2003)
  - JV between Polygram and Warner to distribute third album by the three tenors
  - Agreement allocated distribution responsibilities and provided for sharing of profits and losses
  - FTC challenged agreement not to advertise or discount partners' respective earlier Three tenors recordings during ten week period around launch of the third album
  - Applied framework of *Massachusetts Board of Optometry v. FTC*, 110 F.T.C. 549 (1988), finding that the restraints were "inherently suspect" and that the restraint was not ancillary because
    - — it restrained competition from products that were outside the JV
    - — it was entered into after the JV was formed
- *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 33 (D.C. Cir. 2005)
  - FTC properly analyzed the agreement under *Mass Board*
  - If the restraint is suspect, then it is presumed unlawful, and the defendant must identify some competitive benefit that offsets the anticipated harm

TEN PRACTICAL QUESTIONS FOR ANTITRUST ANALYSIS AND STRUCTURING OF COMPETITOR COLLABORATIONS



Philip C. Larson

Hogan & Hartson, LLP

Washington, DC

May 28, 2009

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INTRODUCTION

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Competitor collaborations can serve a broad variety of useful and lawful functions

The fact that participants compete is only the beginning, not the end, of the analysis

Legality depends in substantial part on whether collaboration

- Significantly restrains competition among competing participants in the collaboration or between them and non-participating third parties, or
- On balance, promotes competition or is competitively neutral and is therefore lawful

We'll be discussing a series of questions you can ask to help you determine and influence which characterization would likely apply

No "right" or "wrong" answer to most of these questions

- They simply help you identify and balance business and legal risks and rewards of various approaches
- There are inevitably tradeoffs in this balancing
- Ultimate legal evaluation of the collaboration depends on the net effect of these tradeoffs under both present and unknown future circumstances

TEN PRACTICAL QUESTIONS

1. What will the collaboration do, and how will it do it?

Helps determine whether

- Collaboration has legitimate objectives that warrant application of rule of reason rather than *per se* rule
- Any ancillary restraints are reasonably necessary to those legitimate objectives

As a practical matter, also helps

- Counsel advise participants on how best to make the necessary "tradeoffs" to achieve their legitimate business objectives with minimal legal risk
- Educate participants on what they are and are not doing as part of the collaboration and thereby avoid inaccurate or ambiguous statements that could unnecessarily undermine the legality of the collaboration

TEN PRACTICAL QUESTIONS

2. What benefits will the collaboration provide to consumers (or other customers) and other third parties?

Participants can obviously seek to benefit themselves by appropriate means

Successful collaborations often provide benefits to third parties as well

Focusing on both sets of benefits in structuring and communicating about the collaboration will increase the likelihood of favorable antitrust review

Optimal situation is to offer a "win/win" solution for the collaboration, its participants, and any third parties with whom the collaboration deals

TEN PRACTICAL QUESTIONS

3. What legal form will the collaboration take?

Depending on collaboration's objectives, could vary widely (separate legal entity, contractual collaboration, purely informal, etc.)

Business and tax, not legal, considerations normally control

Could also affect legal analysis

- Applicability of HSR and other merger notification requirements
- Controlling statutory standard (Clayton Act § 7 v. Sherman Act § 1)

4. In what product or service sectors and geographic areas will the collaboration and participants be active?

Although market definition key to legal analysis, often difficult to determine what relevant product and geographic markets will be in any potential future challenge to the collaboration

- Competitive effects evaluated at time of challenge
- Identity of future complainant and nature of claims unknown
- Facts and market dynamics may change over time

More practical approach is to seek to identify all potentially affected business sectors and parties and satisfy yourself that competitive harm unlikely for each of them without worrying about market definition

- Even if collaboration involves most of industry participants, activities may not be competitively sensitive
- Non-participants may present substantial competition to collaboration and participants
- Number of participants and combined market share of participants and their collaboration not necessarily controlling but always significant

In doing so, keep in mind that the collaboration will be evaluated based on competitive effects at the time any challenge is resolved and that those effects may vary over time

TEN PRACTICAL QUESTIONS

5. Will participants deal exclusively with or through the collaboration?

Answer depends on both legal requirements and economic incentives created by the collaboration

Significance of answer may depend substantially on whether the collaboration represents a small or large percentage of overall activity in the business sectors in which collaboration and participants are engaged

- The greater the percentage, the greater the potential for antitrust risks

TEN PRACTICAL QUESTIONS

6. Will the collaboration permit non-organizers to participate and, if so, will it permit non-organizers to participate on the same terms as owners?

Answer may not matter if participation not necessary in order to compete

- Antitrust laws protect competition, not competitors
- In many instances, non-participants could form a competing collaboration—often a preferable alternative from an antitrust standpoint

Recent Supreme Court precedent may also reduce significance of answer

- *Trinko*
- *LinkLine*

At a minimum, answer may affect likelihood of complaints about the collaboration (whether or not meritorious)

7. What are the standards for granting, denying, or terminating the right to participate in the collaboration and who applies them?

Generally preferable that standards be

- Objective, clearly stated, consistent with collaboration's legitimate purposes, and uniformly applied
- Applied by "disinterested" persons or participants

But

- Answer may not matter if participation not necessary to compete effectively
- Answer may be more important as a way of conveying sense of fairness that discourages complaints about collaboration than as a necessary step for antitrust compliance

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TEN PRACTICAL QUESTIONS

8. Why is each restriction on competition by the collaboration and its participants reasonably necessary to accomplish the collaboration's legitimate purposes?

Again need to consider restrictions that arise from legal requirements or from economic incentives created by the collaboration

Fact-based analysis that evaluates each restriction separately

- Facts that overall collaboration and some ancillary restrictions are reasonable and legitimate doesn't mean that all are
- Often the area that presents the most antitrust risk because participants sometimes tend to go beyond what's necessary for their legitimate purposes to seek the "perfect" arrangement from a business standpoint

9. Will the collaboration result in the exchange of competitively sensitive information among competing participants or have other "spillover" effects?

Such an exchange of competitively sensitive information may raise antitrust concerns even if the collaboration's own basic activities do not

- E.g., a collaboration that competing sellers organize to handle their order fulfillment should not disclose one participant's sales prices and terms to another
- This issue can normally be addressed effectively through "firewalls" and similar arrangements

Key is to identify the potential "spillover" effects from the outset and address them effectively <u>before</u> they prompt antitrust complaints or challenges

TEN PRACTICAL QUESTIONS

10. Who will complain about the collaboration and why?

All of the prior questions are designed to evaluate the potential competitive effects of the proposed collaboration

- Although generally not stated in formal antitrust terminology, they clearly track key elements of the antitrust analysis
- Sometimes hard for business people to relate to
- Also often difficult to answer with regard to unknown future competitive circumstances that may exist by the time any antitrust challenge to the collaboration is evaluated

This question is the most practical and often elicits the best and most useful information

- Business people are often readily able to answer this question and provide information that is invaluable to your antitrust analysis and your advice on structuring the collaboration
- While the fact of a potential complaint may not mean there is an antitrust problem, knowing in advance what it may be and who may make it will often be critical to your efforts to minimize the possibility that a complaint will be asserted and that it will be successful

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Competitor Collaboration Hypo

Companies A and B compete head-to-head in high-tech Product market. As 1 and 2 in the market, each has around a 30% share. The remaining 40% of the market includes three other players that, while not as established in the high-tech Product market, are competitive on innovation and price. The economic downturn has put tremendous pressure on everyone's bottom line. Industry-wide sales have just plummeted over the last 12 months. Big Shot CEOs of A and B were recently at a high-tech Product industry symposium. During a break in the program, Big Shots were talking at the coffee bar and came up with the brilliant idea to combine their R&D efforts and work together to come up with the new next generation high-tech Product. By combining their complementary technical skills and technology strengths, A and B would be able to come up with the very best new high-tech Product more quickly and efficiently, and at the lowest possible cost. Customers will love it and both A and B will be back on financial solid ground before either could get there on their own.

While further details of their new collaboration would be finalized later by the lawyers, Big Shots had a couple further thoughts. Since A and B will be coming up with this new high-tech Product together, they should agree on the price for the new Product. It wouldn't seem fair for the two to compete the profit right out of the new Product that they jointly create. Further, if they're going to have one price for new Product, they would anticipate further cost savings by consolidating into one sales force. After all, why would they need two sales forces to sell the same product? And since customers are all going to want to buy the new high-tech Product and A and B won't have separate sales forces going forward, Big Shots further agreed that they would price their current, separate high-tech Products above the agreed upon price for new high-tech Product. That would assure that customers will be drawn to the new high-tech Product.

Big Shots can't wait to get back to their respective offices and tell their GCs about their great new idea. "Work out the details," Big Shots bark, "we're back on track!" The GCs immediately pick up the phone and call their trusty antitrust lawyers who always provide sage advice.