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Joint Ventures: Avoiding Antitrust Liability After JV is Established

Lessons Learned from Twombly, Dagher, Copperweld and Starr

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Mark J. Botti, Partner, **Akin Gump Strauss Hauer & Feld**, Washington, D.C.

Joseph Miller, Assistant Chief of the Litigation I Section of the Antitrust Division, **U.S. Department of Justice**, Washington, D.C.

William L. Monts, Partner, **Hogan & Hartson**, Washington, D.C.

Wednesday, April 7, 2010

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Joint Ventures – Avoiding Antitrust Liability After the Venture is Established

*The Basic Law and the Private
Litigation Perspective on Concerted
Action*

William L. Monts III
Hogan & Hartson LLP
Washington, D.C.
April 7, 2010



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Joint Ventures as Concerted Action

- Section 1 of the Sherman Act requires some form of concerted action between two or more business entities
- Historically, conduct of joint ventures, particularly ventures between or among competitors, has been treated as satisfying section 1's requirement that there be a plurality of actors
 - *United States v. Sealy, Inc.*, 388 U.S. 350 (1967)
 - *United States v. Topco Assocs., Inc.*, 405 U.S. 596 (1972)
 - *NCAA v. Board of Regents*, 465 U.S. 85 (1984)
 - *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210 (D.C. Cir. 1986) (Bork, J., joined by R. Ginsberg, J.)

Joint Ventures as Concerted Action (Cont'd)

- Many courts and counselors *assumed* that both venture formation and post-formation conduct was concerted action and analyzed the conduct accordingly
- Since *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, 441 U.S. 1 (1979), and *NCAA*, both venture formation and post-venture conduct have been reviewed under the rule of reason, subject to certain exceptions. For example:
 - Price fixing or market allocation that is unrelated to, or remote from, the legitimate purposes of the venture
 - Certain boycotts imposed through the venture
 - Sham ventures or arrangements that are cloaks for what are, in reality, naked agreements to suppress competition

Copperweld and the Single Economic Enterprise Concept

- *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984), resolved a lingering question about whether companies within the same corporate family had the multiplicity of actors required to reach agreement under the Sherman Act
- *Copperweld* holds that a parent corporation and wholly-owned subsidiary are part of a “single economic enterprise” and thus are incapable of conspiring
- *Copperweld* principle expanded by some courts to include:
 - Cases in which one company controls more than 50% of another
 - Cases involving sister corporations wholly owned by the same parent
 - In at least one situation, a case involving separately owned but substantially related companies producing a single product

Copperweld and Joint Ventures

- Despite *Copperweld*, few participants in joint ventures ever claimed that their conduct was that of a single economic enterprise
- Most such cases in which the argument was made involved sports leagues, and the argument was generally unsuccessful. See, e.g.,
 - *North Am. Soccer League v. Nat'l Football League*, 670 F.2d 1249 (2d Cir.), cert. denied, 459 U.S. 1074 (1982)
 - *Sullivan v. Nat'l Football League*, 34 F.3d 1091 (1st Cir. 1994)
 - Cf. *Chicago Prof'l Sports Ltd. P'ship v. Nat'l Basketball Ass'n*, 961 F.2d 667 (7th Cir. 1992), appeal after remand, 95 F.3d 593 (7th Cir. 1996)

Dagher – Can a Joint Venture Be a Single Economic Enterprise?

- *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006), suggests that highly integrated joint ventures can be single economic enterprises, at least when making decisions about what is clearly venture output
- *Dagher* decided not whether conduct was concerted action but whether price-setting on venture output by participants in a highly integrated joint venture was per se illegal
 - *Dagher* involved a joint venture among Texaco, Shell, and Saudi Refining for refining and marketing of gasoline and other products in the United States
 - Formation of venture had been subject to Hart-Scott-Rodino review by the Federal Trade Commission and cleared with certain divestitures
 - Integration was substantially complete such that venture participants effectively ceased to compete with one another in refining and marketing
 - Notably, plaintiffs did not challenge the formation of the venture but only the setting of prices on venture output by venture participants after formation

Dagher – Can a Joint Venture Be a Single Economic Enterprise? (Cont'd)

- The Court's rationale for the *Dagher* holding strongly suggests that certain activities of highly integrated joint ventures should be treated as the conduct of a single firm:

When “persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit . . . such joint ventures [are] regarded as a single firm competing with other sellers in the market.”

Dagher, 547 U.S. at 6 (quoting *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 356 (1982)).

- *Dagher*, therefore, implies that, at least in some instances, post-formation conduct of joint venturers can be treated as conduct of a single economic enterprise.

American Needle v. NFL

- All of the foregoing themes are playing out now in the Supreme Court in *American Needle v. NFL*
- The NFL is an integrated joint venture among 32-member clubs
- Integration is necessary to produce the league's main product – championship professional football
- Yet the individual member clubs are separately owned, operate independently in some respects, and compete or appear to compete in some areas, such as labor markets (*i.e.*, players and coaches) and perhaps other areas
- American Needle challenges a collective decision by the NFL member clubs to license club-owned trademarks and logos exclusively to Reebok for hats and other apparel
- NFL defended by claiming that decision is not subject to section 1 because the league is a single economic enterprise, at least for licensing purposes
- Seventh Circuit accepted the NFL's argument

American Needle v. NFL

- *American Needle* squarely presents how far the *Dagher* rationale may extend
- No dispute that the *formation* of a joint venture is concerted action
- The issue is what *post-formation* conduct of a venture is concerted action and what is that of a single economic enterprise. Three positions:
 - American Needle – Common control and ownership is required
 - NFL – Decisions related to production and output of venture product and other internal matters are actions of a single enterprise
 - Solicitor General – Single enterprise exists only when venturers have “effectively merged” their operations
- Decision expected by June

Pleading Concerted Action

- *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), establishes the pleading standard for agreement:
 - Simply alleging parallel conduct is not enough
 - Complaint must allege “enough factual matter (taken as true) to suggest that an agreement was made”
 - Factual allegations of agreement must be plausible
 - Allegations of parallel behavior “must be placed in a context that raises a suggestion of preceding agreement, not merely parallel conduct that could just as well be independent action.” *Twombly*, 550 U.S. at 557.
- *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009)
 - Reiterates *Twombly* standard
 - Legal conclusions framed as factual allegations not entitled to presumption of truth

Starr v. Sony BMG

- Ties together the concerted action issues of *American Needle* with the pleading requirements of *Twombly*
- Challenge to certain Internet Music joint ventures and conduct surrounding the ventures
- Allegations
 - Defendants were four music companies with combined 80% market share
 - Defendants adopted common practice with respect to digital rights management
 - Defendants all used most-favored-nations clauses in their music licensing agreements and took some actions to conceal them
 - Defendants all were experiencing declining costs for music distribution but raised prices per song; prices alleged to be unreasonably high
 - Defendants imposed high prices and digital rights management on other Internet Music vendors besides their own joint ventures
 - Defendants actions subject to investigations by Department of Justice and New York Attorney General
 - Some suggestion that the ventures were sham
 - Reviewers had alleged that “no one in his right mind” would buy Internet Music from the ventures under the terms that they imposed
- Second Circuit Held Complaint Sufficient to State a Claim for Relief

Starr v. Sony BMG – Some Questions

- Not clear that plaintiffs challenging venture formation, but plaintiffs did purport to claim that the ventures were the means by which anticompetitive agreements were implemented – seems to focus on post-formation conduct
- Does the plausibility standard require any factual allegations that tend to negate readily identifiable unilateral explanations for the conduct?
 - Some readily identifiable unilateral explanations or responses seem quite clear:
 - *Allegation*: Defendants adopted common practice with respect to digital rights management
 - *Unilateral Explanation*: Each defendant taking reasonable steps to protect its copyright from piracy
 - *Allegation*: Defendants all used most-favored-nations clauses in their music licensing agreements and took some actions to conceal them
 - *Unilateral Explanation*: Each defendant seeking best deal available for its portfolio of music

Starr v. Sony BMG – Some Questions (Cont'd)

- *Allegation:* Defendants all were experiencing declining costs for music distribution but raised prices per song; prices alleged to be unreasonably high
- *Unilateral Explanation:* Each defendant entitled to charge what the market will bear; declining distribution costs could be competed away in higher rights acquisition fees to artists
- *Allegation:* Defendants imposed high prices and digital rights management on other Internet Music vendors besides their own joint ventures
- *Unilateral Explanation:* Seems further to suggest that each defendant was protecting its copyright interest from piracy and seeking what the market will bear
- *Allegation:* Defendants actions subject to investigations by Department of Justice and New York Attorney General
- *Response:* Investigation is evidence of agreement?
- *Allegation:* Reviewers had alleged that “no one in his right mind” would buy Internet Music from the ventures under the terms that they imposed
- *Response:* Allegations of opinion of third party entitled to presumption of truth?

Starr v. Sony BMG – Some Questions (Cont'd)

- Does fact that conduct alleged might be per se illegal matter?
- If so, why should mode of analysis determine existence of concerted action?
- Does fact that ventures alleged to be shams matter?
- How is that squared with notion that ventures cleared by Justice Department at the time of formation?

Conclusions – Lessons to be Learned

- Despite *Copperweld* and *Dagher*, post-formation venture conduct, including internal matters related to venture output or governance, may still be viewed as concerted action. *American Needle* may clarify this issue
- Most challenges to post-formation venture conduct will be subject to the rule of reason
- *BUT*, if venture participants arguably compete with one another outside the scope of the venture, internal venture conduct might be used as evidence of suspect agreements or even per se illegal agreements suppressing non-venture competition
- Minimizing antitrust risk requires careful planning at the formation stage and safeguards after formation to ensure that post-formation conduct serves legitimate venture purposes **and** avoids anticompetitive effects on non-venture output

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AVOIDING ANTITRUST LIABILITY AFTER JV IS ESTABLISHED: PERSPECTIVES FROM THE ANTITRUST DIVISION

Joe Miller
Assistant Chief, Litigation I Section
Antitrust Division

Disclaimer: the views expressed herein are my own and do not purport to reflect the views of the Antitrust Division or the Department of Justice

Government v. Private Plaintiff: What's Different?

- Pre-complaint discovery - government should have substantial factual basis for complaint
 - Pleading standards: does Twombly rationale apply?
 - Typical remedy is equitable - courts may be less concerned about threats of expensive discovery to force a monetary settlement
- Case selection - policy considerations important
- Evaluation of the jv: welfare effects v. structure of the entity, competitive reality v. formalism

Insights From a Recent JV Investigation

- Physician joint venture (assuming not a per se type boycott)
 - Prosecutorial discretion: past conduct v. future effects, what if they cleaned up their act?
 - Likelihood of efficiencies
 - Broader meaning than variable cost savings
- Integrated jv's could be evaluated under Clayton 7 or Sherman 1 – same rule of reason analysis

How to choose the appropriate mode of analysis?

- What if the efficiencies are questionable? Is truncated rule of reason appropriate?
 - Purpose of jv can be important – intent to raise price or create a new product or better service? How closely related is the pricing mechanism to the consumer benefits?
- Case law is the authoritative guide. Other sources of insight: Competitor Collaboration Guidelines, Health Care Statements, speeches. Contrast with Horizontal Merger Guidelines

How to Provoke a Joint Venture Investigation (in my Section)

- More interested in compelling facts than legal analysis – don't stuff complicated economics into a per se box
- Exclusion from the jv is not enough -- need to show harm to competition
 - Prices to consumers going up? Superior product excluded from the market? Innovation stifled?
- Think about my internal process: pre-complaint vetting process includes economists, Office of Operations, Deputy Assistant Attorneys General, AAG. I need some realistic path to bringing a case



Joint Ventures – Avoiding Antitrust Liability After the Venture is Established

Staying out of the Casebooks and Away From Government Investigations

Mark J. Botti
Partner, Akin Gump Strauss Hauer & Feld LLP

April 7, 2010

**AKIN GUMP
STRAUSS HAUER & FELD LLP**

Scenarios to Illustrate Antitrust Avoidance Techniques

- One Major Assumption: The "formation" of the Joint Venture in each scenario is not an antitrust violation
- Some Antitrust Lessons from *Starr*
 - Parallel conduct might suffice to infer an agreement depending on the context
 - Agreements not within the scope of what the joint venture does are more at risk
 - Joint ventures might serve as a means to implement or further anticompetitive agreements
 - For example, creating circumstances where joint venture partners might discuss or share information regarding topics competitively sensitive to activity outside the scope of what the joint venture does

Scenarios to Illustrate Antitrust Avoidance Techniques

■ The Three Scenarios

- Research Joint Venture: Athletic Apparel
- Production Joint Venture: Fire Trucks
- Sales/Marketing Joint Venture: Office Supplies to Customers with Centralized Purchasing

■ Counseling Framework:

- What are the antitrust risks for conduct not within the scope of what the joint venture does?
- What are the trade-offs between antitrust risk and business goals?
- Does the advice vary if the JV operates outside of the U.S.?

Scenario 1: Apex and Frio Athletic Apparel Companies Research Joint Venture

■ Apex

- Full range of athletic apparel products
- Significant success in outdoor products, such as camping, hiking and mountain climbing; but makes other products including shoes, boots, shirts, shorts that cross-over

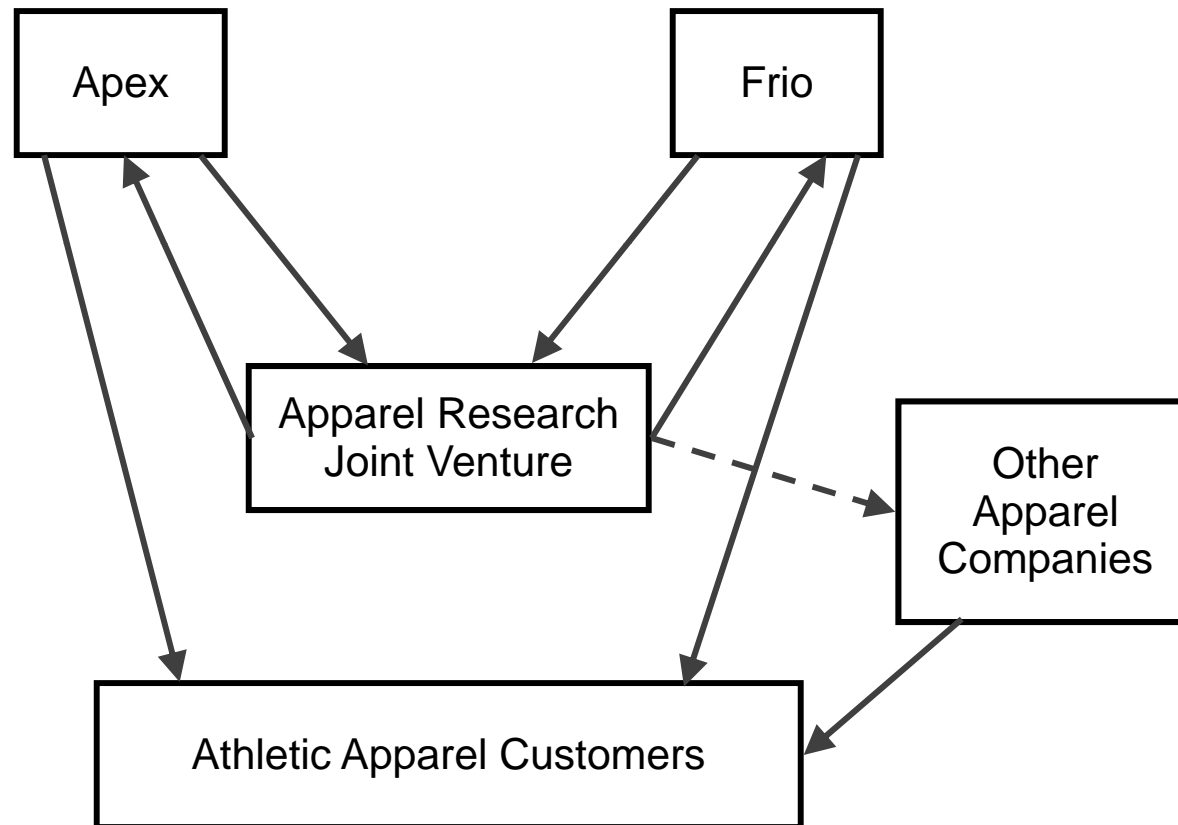
■ Frio

- Full range of products
- Significant success in winter sports products, used for alpine and cross-country skiing, skating, but makes other products as well

Scenario 1: Apex/Frio Research Joint Venture

- Contribute patents rights (cross-licensing the output), trade secrets, research leads, and research personnel
- Each provides management personnel and funding
- Share market assessments
- No field of use limitations. Each company may make full use of the output of the joint venture

Scenario 1: Apex/Frio Research Joint Venture



Scenario 1: Apex/Frio Research Joint Venture

- What are the antitrust risks?
 - Market allocation (hard or soft) between Apex and Frio
 - Coordination with other apparel companies

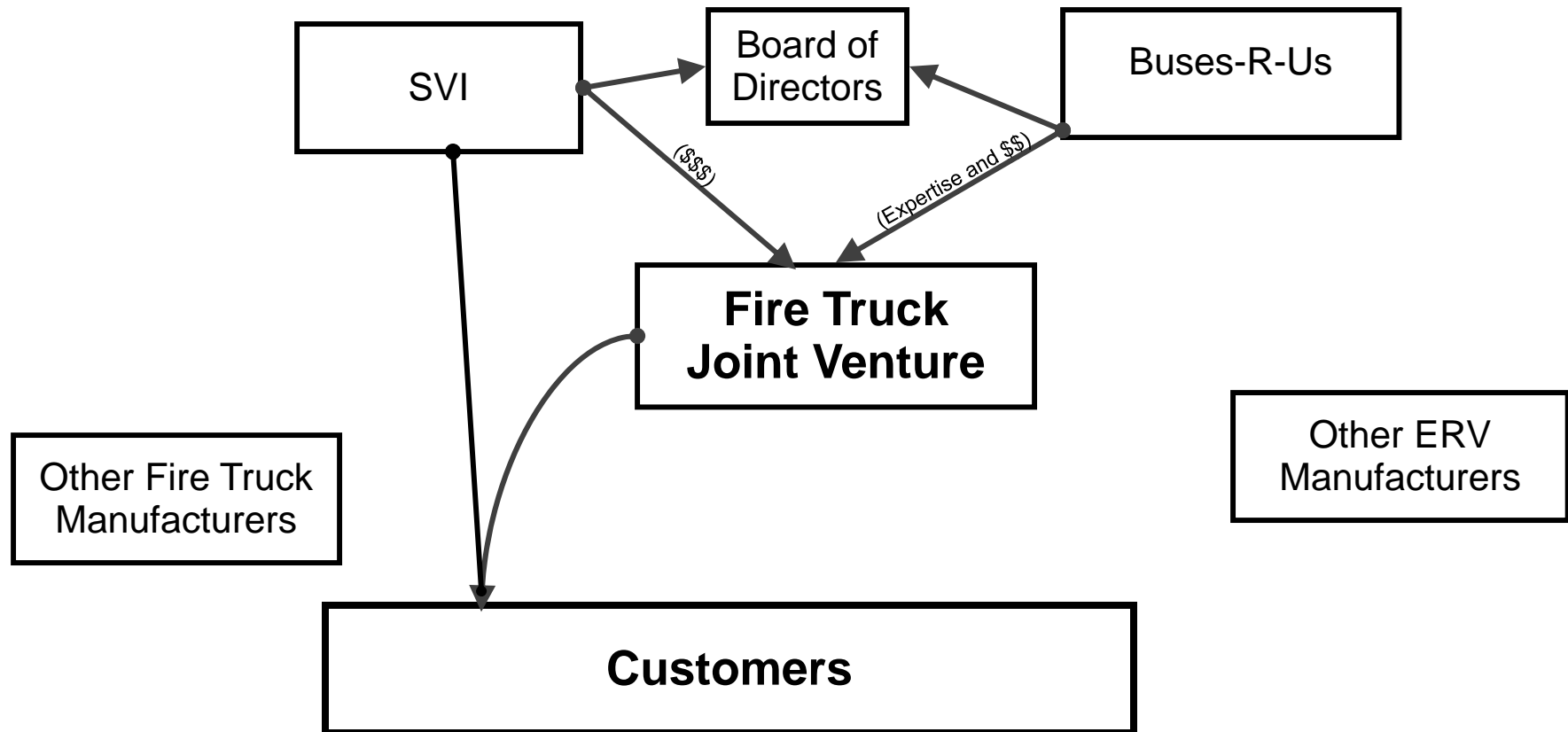
- When do the risks arise?
 - Board of Directors meeting
 - R&D Committee meeting
 - Sales Communications to other apparel manufacturers

Scenario 2: Fire Trucks Production Joint Venture

- Buses-R-Us
 - Makes school buses and other similar vehicles
 - Manufacturing similar to that needed to produce fire trucks
- Safety Vehicles, Inc.
 - Makes ERVs
 - Contracts to supply them to cities, states, other government agencies and private parties
 - Cannot make fire trucks on its own
- Joint Venture to Make Fire Trucks
 - Mutual covenants not to compete



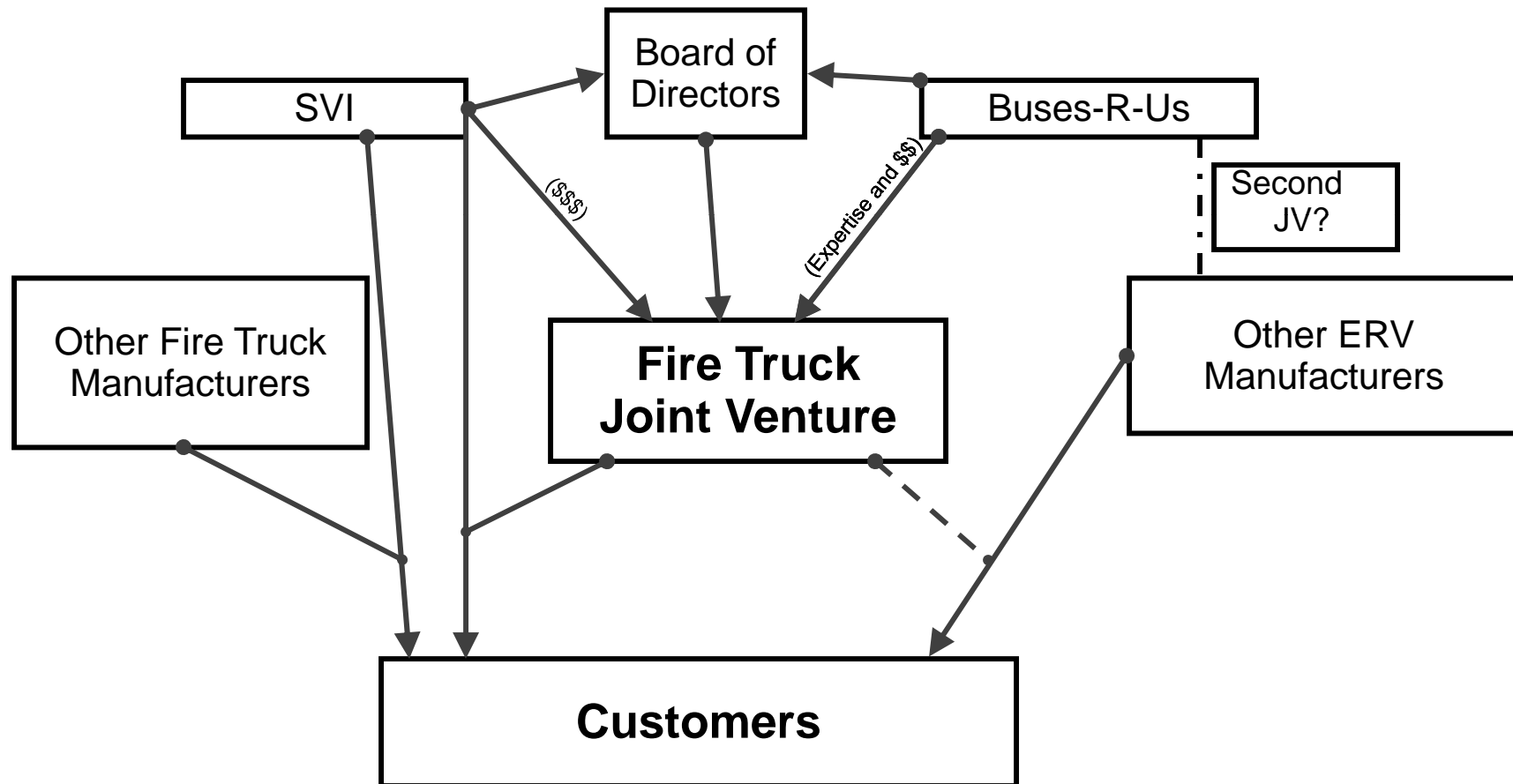
Scenario 2: Fire Trucks Production Joint Venture



Scenario 2: Fire Trucks Production Joint Venture

- **What if business needs make a covenant not-to-compete impractical?**
- **What are the antitrust risks?**
- **When do the risks arise?**

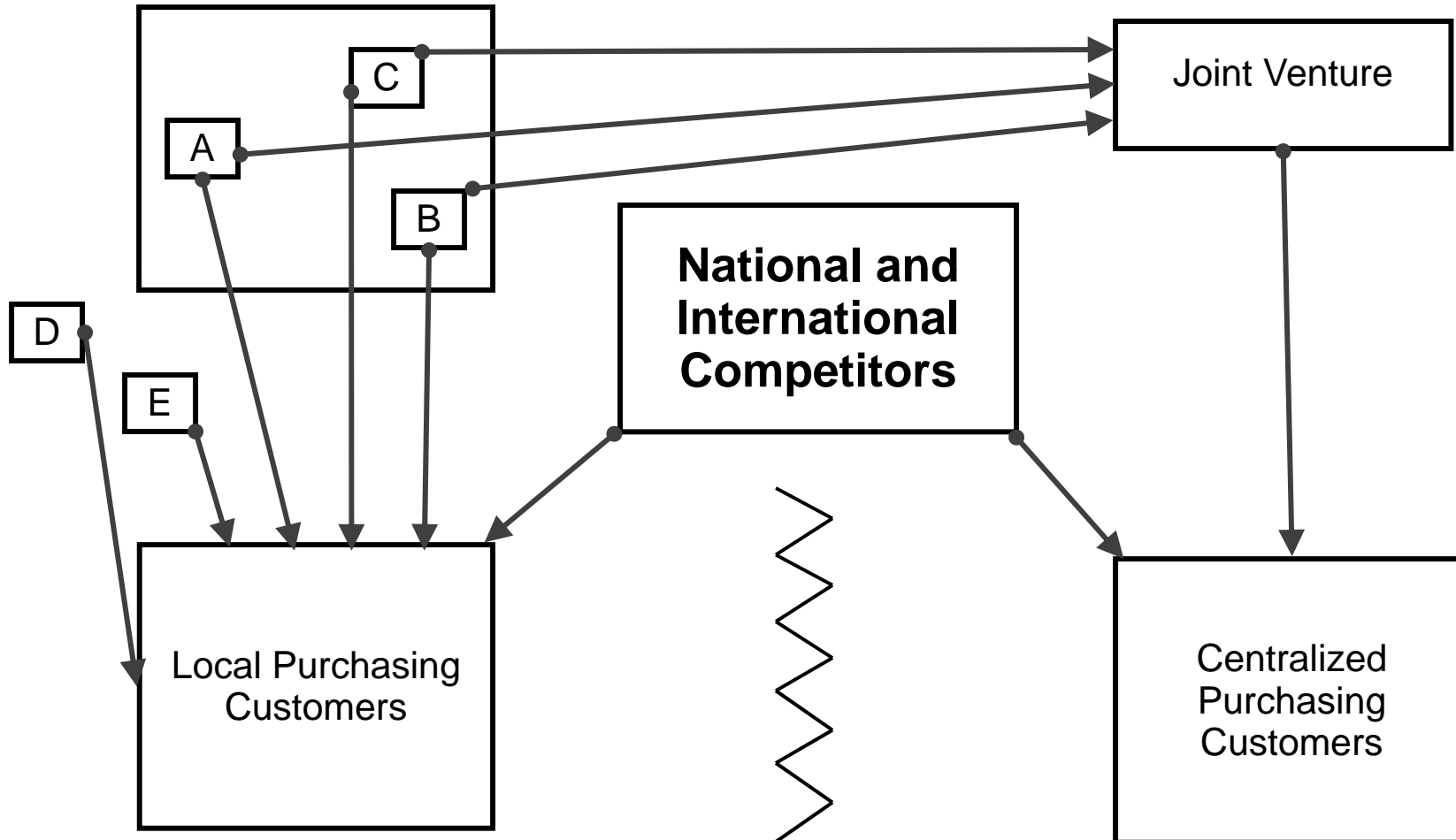
Scenario 2: Fire Trucks Production Joint Venture



Scenario 3: Office Supplies Sales/Marketing Joint Venture

- Market for office supplies is significantly bifurcated.
 - Many companies purchase their supplies locally.
 - Many companies also use centralized purchasing to purchase on a national or international basis.
 - National and International supply companies sell to both segments.
 - Small and regional office supply companies across the United States and Europe can only sell to companies that purchase locally.
- Formation of Joint Venture to aggregate a network of small and regional companies to allow them to compete for large accounts.
 - Non-exclusive
 - Some participants compete for local accounts

Scenario 3: Office Supplies Sales/Marketing Joint Venture



Scenario 3: Office Supplies Sales/Marketing Joint Venture

- What are the antitrust risks?
 - Collusion in the local markets
 - Tying or some similar claim: *de facto* exclusivity
- Where do the risks arise?
 - During communications regarding centralized purchasing customer opportunities