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ANTITRUST ANALYSIS OF JOINT VENTURES AND COMPETITOR COLLABORATIONS: A PRIMER FOR THE CORPORATE LAWYER

RICHARD J. HOSKINS*

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I. INTRODUCTION

In the last decade, increased globalization of markets and the speed of information dissemination and processing have made joint ventures, strategic alliances, and other forms of competitor (or "horizontal") collaboration[1] more frequent and more essential. Whether in the form of loose "strategic alliances" or formal joint ventures, the economic appeal - and procompetitive potential - of such collaborations is manifest: they permit the kind of specialization of function and economies of scale that are otherwise available only through larger aggregations of capital and talent, such as result from mergers. Thus, they permit smaller players to compete more effectively against giants. In contrast to mergers, competitors who "joint venture" remain competitors in all *other* aspects of their business; they thus create a blend of cooperation and competition in ways not encountered under ordinary competitive conditions. But, competitor collaboration has the face

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[1] Except as otherwise indicated by context, "joint venture" and "strategic alliance" are used interchangeably as examples of "competitor" or "horizontal" collaborations. The discussion throughout is of such "horizontal" ventures; some vertical collaborations raise much less antitrust concern, and others not at all. *See generally*, *Antitrust Guidelines for Collaborations Among Competitors*, issued in April 2000 by the Federal Trade Commission and U.S. Department of Justice, Antitrust Division ("*Collaboration Guidelines*"). The *Collaboration Guidelines* are summarized in Appendix A. While the focus of this article is on U.S. competition law, a brief summary of European treatment of joint ventures is contained in Appendix B.

of Janus; precisely because it blends cooperation and competition, it carries within itself the seeds of both procompetitive benefits and anticompetitive dangers.

This article, for the benefit of the corporate lawyer who is not an antitrust specialist, aims to provide basic guidance as to the legal parameters of competitor collaboration. The stakes for understanding those limits are high. The antitrust laws of the United States prohibit any "contract, combination or conspiracy... in restraint of trade."[2] The hard core of antitrust law, backed up by criminal sanctions including prison terms for executives, is the prohibition against agreements between competitors, whether explicit or tacit, setting the prices they will charge, establishing the output they will produce, dividing markets between them, or otherwise coordinating their sales and marketing functions. These are the decisions and activities on which competition is expected and required; cooperation is forbidden.

A. *Fundamentals of the Antitrust Perspective*

The objective of the antitrust laws is the enhancement of productive efficiency. Competition is essential to consumer welfare through that objective. Without the spur of competition, goods and services will be produced inefficiently, which is to say that more than the necessary amount of scarce social and economic resources (like talent and capital) will be absorbed in the enterprise, leaving less to serve other social needs. Without competition, even an efficiently run business will benefit only the officers, employees, and stockholders of the company, not consumers though lower prices and better quality. With vigorous competition, both efficiency (including a reasonable return to stockholders) and consumer welfare are served.

Market power, the archenemy of competition, is the ability of a seller profitably to raise prices above the competitive level. An absolute monopolist has maximum market power, but appreciable market power can also exist in companies who have less than all of a market. Here is how it works. In a competitive market (in which no seller has market power), a seller who raises its prices above the competitive level will be punished and forced to roll back its prices, because its loss of unit sales will more than offset its gain in per-unit price, so gross revenues will decline. A seller with market power, who prices above the competitive level, on the other hand, will increase its gross revenues, despite the loss of unit sales. Indeed, its market power will make

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2 15 U.S.C. § 1 (2000).

it possible (and thus desirable) to reduce output *in order to* raise prices and increase gross revenues.

Reducing the number of competitors, by horizontal merger or even by horizontal joint venture, presents at least the risk of reducing competition. In a merger, the reduction (by one) of the number of competitors is permanent and cuts across all product lines in which they competed. In a joint venture, the reduction is not permanent and typically covers less than the entire product line, so in that sense is less threatening to competition. Ironically, however, in other ways, the joint venture could be more menacing than a merger; of which more later.

A merger, in reducing (by one) the number of competitors in a market, necessarily increases the level of concentration in that market. Beyond a certain point, an increase in concentration may give rise to market power and an increase in anticompetitive risk.[3] This may occur in two ways, both of which are discussed in the *Horizontal Merger Guidelines* of the U.S. Department of Justice (Antitrust Division) and Federal Trade Commission ("*Merger Guidelines*").[4] First, an increase in concentration may give the new combined company (or others remaining in the market), the unilateral ability to raise prices above the competitive level and profit by it. This is because (everything else equal) the greater the market share of a firm, the greater is its ability (and thus temptation) to reduce its individual output and cause a price rise in the entire market. This is central to the feared "unilateral effects" that may result from an increase in concentration.[5] In addition, there may be "joint effects" as the market becomes more concentrated with fewer players, explicit or tacit collusion among sellers becomes easier.[6]

A joint venture or other collaboration between competitors is, of course, not a merger. However, depending on the number of products affected and the duration of the arrangement, it may have the same concentrating effects as a merger—at least as to *those* product lines and for *that* period of time. Indeed, the Federal Trade Commission and Department of Justice have said in the *Collaboration Guidelines* that, where a horizontal collaboration is

[3] The correlation between increased concentration and anticompetitive effects is much debated in the economic literature. There is no question that the correlation is very imperfect, because instances abound of markets with only two or three sellers, but fierce competition nonetheless. On the other hand, there is ample evidence that in many industries, the march toward smaller and smaller numbers of competitors will, *at a certain point* (and the point is industry-specific), result in supracompetitive pricing. Much has to do with economies of scale and minimum efficient size, and these will vary greatly from industry to industry and market to market.

[4] 57 Fed. Reg. 41552-01 (1992) ("*Merger Guildlines*").

[5] *Id.* at § 2.2.

[6] *Id.* at § 2.1.

complete as to a particular market and not limited to less than ten years, they will analyze it under the *Merger Guidelines.*[7]

Even where a joint venture or other collaboration is limited to less than ten years, or does not eliminate all competition between the venturers in a relevant market, it remains the fact that in some respects, a collaboration may present more of an anticompetitive danger than a complete merger. A merger, to be sure, eliminates competition between the merging partners for all times and all products, which collaboration typically does not. On the other hand, the merged companies will be under common direction and management, and thus will have the ability to be a tougher, sharper competitor than the two companies separately could have been. In addition, many economies are correlated positively with increased size, with the result that the combined company may be more efficient than before. The result is the creation of a stronger competitor in the marketplace—and, assuming strong post-merger competition in the market, one that will be spurred to pass on to consumers the efficiencies and benefits of the merger in the form of lower prices and better quality and service. These are obviously significant procompetitive benefits that offset the anticompetitive concerns of an increase in concentration, and result in many horizontal mergers being approved.

A joint venture or horizontal collaboration, on the other hand, does not involve a complete integration of assets; nor does it result in one stronger, more focused competitor under central direction and discipline. Efficiencies may result, but at a more modest level. Because a joint venture involves only a partial integration of assets and resources, has only limited objectives for a finite period of time, and deals with management and control emanating from at least two centers of power (the owners), it does not present the same clear menu of procompetitive benefits.

There is one other difference. Everyone knows that the merged companies will no longer compete with each other; that is inherent in the merger, and factored into the antitrust analysis, at the time the deal is done. On the other hand, joint venturers are supposed to remain competitors outside the parameters of the joint venture. Competitors are not supposed to talk to each other very much; and certainly not about prices or future marketing. If they do, an agreement between them may be inferred and serious, even criminal, consequences may ensue. Yet, as joint venturers, these competitors are expected to cooperate, to talk and plan jointly. How to carry out the joint venture without providing a venue for collusive information exchanges on other products? The most important way is to ensure that the personnel working in the joint venture are separate from, and

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[7] *Collaboration Guidelines, supra* note 1, at § 1.3.

do not communicate with, the personnel running the competitive lines of business. The higher the firewall the better; if the joint venture is a separate corporation with its own staff and employees, ideally located in separate offices and facilities, that provides maximum protection. Even short of that, there need to be clear lines of authority separating the functions of joint venture personnel from personnel of the still-competing businesses, with absolute prohibitions on communication concerning prices and marketing. Antitrust counsel can set up organizational and functional firewalls, educational and enforcement mechanisms, and audits to ensure that the separation "on paper" is a separation in the real world. The avoidance of "spillover effects" from a collaborative arrangement to the still-competing spheres of the collaborators' businesses is essential. If it is not avoided, a joint venture or competitor collaboration will be treated as a mere cover for a cartel, which is per se illegal and subject to criminal prosecution.[8]

All of that said, it still remains that horizontal joint ventures, properly organized and insulated from the competitive businesses of the co-venturers, have many procompetitive benefits. In large measure, they are the same benefits as those of a merger of competitors, the difference being one of degree. Indeed, merger analysis and collaboration analysis ask fundamentally the same questions: What effects will the arrangement have in the relevant market? Will it enhance or undercut opportunities for the exercise of market power? What will be the result for consumers? Do the procompetitive effects (including efficiencies) outweigh the anticompetitive potential?

B. *The Benefits of Competitor Collaboration*

Perhaps the most important procompetitive result of joint ventures is that they can give small sellers the ability to compete better against big sellers (and thus perhaps eliminate the need to merge at all). By combining forces, co-venturers can spread costs and risks, achieve economies of scale, specialize, make significant technological investments, and in general, emulate many of the advantages of their bigger, fully integrated rivals. Thus, it is hardly surprising that competitors are creating joint ventures or strategic alliances to engage jointly in research, product design, production manufacturing, purchasing, and even marketing and selling. The functions of joint buying and joint selling are especially well adapted to "B2B" website marketplaces, a subject that will be discussed in detail later.

In a sense, cooperation (in some respects) coexisting with competition (in other respects) is nothing new—nor is the observation that in many

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[8] *Id.* at § 1.2.

fields, cooperation is the very precondition to competition. Thus, competition among major league sports franchises depends entirely on their cooperation with regard to, e.g., the rules of the game and the scheduling of contests.[9] As far back as the Nineteenth Century, competition among railroads would have been severely hampered had they not adopted uniform track sizes for their rolling stock. Indeed, all forms of public transportation require elaborate cooperation among providers in, for example, sharing passenger terminals and facilities. With the advent of high-technology products and enhanced "network effects," cooperation among competitors becomes even more essential. Thus, it is in the interests of consumers (and of competition) that makers of DVDs and CDs agree on a single operating standard, so consumers can play the different products on a single player. Computer users do not want a variety of "platforms" for software, undercutting the compatibility of various end-use programs available for sale and use.

These are all procompetitive uses of cooperation among competitors. The key is making sure that competitors cooperate only where cooperation enhances their competition, compete otherwise, and have a fairly clear idea of where the line is drawn.

II. THE BUSINESS TO BUSINESS MARKETPLACE WEBSITE

In many ways, the paradigm of the "new cooperation" in which competitors engage is the business-to-business website marketplace ("B2B"). As the name implies, B2Bs create a market in cyberspace where businesses can buy their inputs or sell their outputs, not to consumers, but to other businesses along the vertical chain that leads eventually to the consumer. Sometimes a B2B is owned independently of the buyers and sellers who utilize it, and this independence reduces antitrust concerns. Often, however, it is owned jointly by buyers and sellers who transact business at the website and compete against each other in the market for the sale of their goods.

These web-based marketplaces have become an important feature of a number of important industries, including the automotive, aerospace/ defense, electronics, energy, oil, telecommunications, food and beverage, rubber, and a variety of other industries. Their potential procompetitive benefits are manifest: lower transaction costs (including administrative costs of sellers and search costs of buyers), standardized parts and modules, improved supply chain management, and broader participation, on an equal footing, by market participants large and small.

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[9] NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85 (1984).

What, then, are the antitrust concerns? Essentially, they are the same concerns there always are with respect to joint ventures between competitors, with an overlay owing to a special characteristic of horizontally-owned B2B sites: the B2B joint venture creates a marketplace in which others are invited to (or may need to) compete. It is, in effect, a "platform" for further competition and cooperation. Furthermore, because the value of the website increases as more and more sellers or buyers participate, it displays "network effects" that both encourage cooperation and, ultimately, may threaten competition, by making the B2B, if not the only game in town, at least an essential marketing facility for players in that industry. In other words, it may gain market power as a marketplace. Against this background, the FTC conducted a public workshop and study of B2Bs,[10] in which antitrust dangers were grouped into three broad categories. Other commentators have generally followed a similar division of issues.[11] To understand the categories of concern is to be alert to how they may be managed. The three categories are: issues of inclusion and exclusion, problems of information-sharing and special issues with joint buying.

A. *B2B Inclusion and Exclusion*

Who is included and who is excluded (as well as how and why) is of little concern when the B2B is young and not very powerful. So long as there are significant alternative channels for doing business (including both other B2Bs and non-B2B "conventional" marketplaces), there is unlikely to be competitive harm in being excluded from a particular B2B. As the B2B grows, however, the likelihood increases that those not allowed to participate will suffer genuine competitive harm, by virtue of being denied access to the playing field (or at least an "essential" playing field) where the game is played. At that point, the B2B itself has market power, and the exclusion of newcomers may be truly anticompetitive. The *Collaboration Guidelines* provide an absolute safe harbor where a joint venture accounts for 20% or less of the relevant market, *i.e.*, in the case of a competitor-owned B2B, a "marketplace market share" of where it accounts for no more than 20% of market transactions.[12] At some point beyond 20%, however, significant competitive concerns could arise.

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[10] "Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces: A Report by the Federal Trade Commission Staff," October 2000 ("FTC Report"). The public workshop was conducted in June 2000.

[11] *See, e.g.*, articles collected in Vol. 15 *Antitrust Magazine*: "Inside the Internet Bazaar: B2B Exchanges" (Fall 2000).

[12] *Collaboration Guidelines*, *supra* note 1, at § 4.2.

How to minimize the antitrust concerns? First, as noted above, if the B2B is owned and controlled independently of the competitors, the danger of anticompetitive uses of market power is greatly reduced; at a minimum, the B2B has economic incentives to maximize its own utility as a marketplace, without regard to the specific interests of specific participants. (This is not to ignore the anticompetitive possibilities of pressure from big participants, or outright agreements between powerful participants and the B2B, which is why genuine independence is the touchstone.)

Even if the B2B is a joint venture of competitors, however, there are reasonable steps to minimize antitrust dangers. The rules of inclusion and exclusion should be uniform, public, and neutral—and based on economically and rationally defensible criteria. An open marketplace—one with no upper limit on participants—is obviously to be preferred where feasible. Maximum practical access to newcomers, subject to reasonable regulations and controls, is a good rule.

Despite the suggestions of the last paragraph, is there a point where a B2B could become such a powerful marketplace that the taking on of new participants could endanger the viability of other, competing marketplaces, including other B2Bs, and could this be a competitive concern? Possibly so; this is the problem of "overinclusion," and should be analyzed for just these dangers by antitrust counsel, as the "marketplace market share" of the B2B becomes truly significant—say 50% or more. Yet even here, great care must be taken before deciding to limit new participants—since this is the very same range of B2B size, importance and market power where the exclusion or limitation of new members (even for the procompetitive purpose of avoiding monopoly status of the B2B) could have the anticompetitive effect of endangering the viability of excluded new participants as competitors in the sale of the downstream products. So even here, limitations on membership or new membership must be approached very carefully.

Without getting to the point of limiting new members, however, there are less drastic steps a B2B can take to avoid unnecessarily hindering the development of rival marketplaces. Basically, the B2B (once it is a viable and established marketplace) should minimize or avoid rules or incentives for its members to participate exclusively with itself. Thus, prohibitions on investment in or trading on other or competing B2Bs, high minimum volume or percentage volume requirements that might have the same effect, or excessive volume-based rebates or revenue-sharing arrangements should be scrutinized carefully. Whether they can be justified as necessary B2B-boosting devices, or may be suspect as rival-hindering incentives for B2B exclusivity, will depend largely on the B2B's market share and market power in relation to smaller rivals. As with any pattern subject to rule of reason antitrust inquiry, much conduct that is procompetitive for a small start-up

can turn anticompetitive as the company becomes established and approaches the ability to wield market power.

Finally, in addition to the foregoing concerns with excluding new members or hindering rival B2B marketplaces, there is an additional set of exclusionary concerns: namely, that within the horizontally-owned B2B itself, the owners may be tempted to operate the B2B in a way that competitively hinders non-owning competitors who transact business on the website. This points to the need for rules and practices for the *operation* of the B2B (not just for admission to membership) that are uniform, public, neutral, and grounded in economically defensible criteria. In this connection, it must be borne in mind that antitrust boundaries are exceeded, not just by excluding new members in certain circumstances, but by admitting them on unequal terms, or discriminating against them once admitted. Such discrimination (which may be subtle and practical, rather than written into the rules) may raise the rivals' costs of doing business, and thus cause economic harm to them. An example of such a situation comes from the airline industry, where computerized reservation systems owned by certain airlines, but displaying flight information from others as well, favored flight information for the owner-airlines by displaying it ahead of objectively "better flights" by non-owner airlines.[13]

B. *B2B Information Sharing*

At least since the Supreme Court's decision over thirty years ago in *Container,*[14] it has been understood that communication between competitors about current or future prices (or information affecting price) is highly suspect, because it is but a short step from price-talk to price-fixing or tacit collusion. It is not surprising, therefore, that a competitor-owned and operated B2B marketplace would raise information-sharing concerns. On the other hand, current and accurate information concerning completed market transactions is essential to the efficient operation of a market. Depending on its nature, the circumstances, and the structure of the market, information can be significantly procompetitive or potentially anticompetitive—or both. In particular, a highly concentrated market presents special risks that competitors who are fully and quickly aware of their competitors' pricing conduct will engage in tacit collusion.

The discussion earlier of "spillover effects," and suggested steps to prevent such effects, is applicable here. Independent management, separate

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[13] *In re* Air Passenger Computer Reservations Sys. Antitrust Litig., 694 F.Supp. 1443, 1450, 1474 (C.D. Calif. 1988), *aff'd,* 948 F.2d 536 (9th Cir. 1991).

[14] United States v. Container Corp. of Am., 393 U.S. 333 (1969).

personnel, firewalls between functions and information streams, and clear rules on what can and cannot be discussed with whom, are all useful ways to avoid inappropriate information sharing among competitors operating in the same B2B marketplace.

The most basic protection against competitive information sharing is probably the most important one: the providing of distinct portals for each participating seller or buyer to communicate and transact business confidentially with its respective customers. In addition, care must be taken to ensure, on the one hand, that B2B owner-participants not have "privileged" access to certain information just among themselves, and on the other, that equal (appropriate) information access is provided to all web participants on an equal footing. Competitor knowledge of sales and pricing information with respect to completed sales is generally procompetitive—but should be available to all.

C. *B2B Joint Purchasing*

A competitor-owned B2B website is typically operated either for the purchase of goods (such as inputs for the manufacture of automobiles or aircraft) or for the sale of goods (such as chemicals or raw materials which are themselves inputs for downstream manufacturing). An example of the former is Covisint, a B2B for the purchase of automobile parts owned by General Motors, Ford, DaimlerChrysler, Renault, and Nissan. In September 2000 the FTC closed its investigation of Covisint without challenge, but reserved the right to look again as the joint venture proceeds in actual operation:

> "Because Covisint is in the early stages of its development and has not yet adopted bylaws, operating rules, or terms for participant access, because it is not yet operational, and in particular because it represents such a large share of the automobile market, we cannot say that implementation of the Covisint venture will not cause competitive concerns."[15]

Joint purchasing arrangements have long been recognized as fundamentally procompetitive, insofar as they obtain better pricing by aggregating purchases, permitting suppliers to realize efficiencies and to reflect those efficiencies in lower prices. These, in turn, lower the cost of

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[15] *In re* Covisint, Inc., File No. 001 0127 (Sept. 11, 2000), closing letter to General Motors Corp., Ford Motor Co., and DaimlerChrysler AG.

downstream production for the buyers and ultimately redound to the benefit of consumers.[16] For these reasons, buyer-owned and operated B2Bs should be less competitively sensitive than seller-operated ones. After all, buyers have a common interest with consumers in driving down the cost of inputs, which B2B purchasing, with its many efficiencies, will tend to do. Sellers, on the other hand, are dealing in their final output; they have no further involvement down the distribution chain. Their interest—not shared by consumers—is to fetch the highest price for what they are putting on the website.

All this being true, what is the antitrust problem? Mostly, there is not one—until the buying group gets big and powerful. The problem arises at the point where the B2B participants (a) represent a substantial collective share of all the purchasing power for the products involved, and (b) aggregate their purchases, thus acting as a collective entity. When these conditions are met, monopsony market power may be exercised to drive down the prices by reducing the collective purchases of the group. This is merely the reverse (buyer) side of what was discussed earlier as seller-side market power. The greater the market share of a group of buyers purchasing as a collective entity, the greater is its ability (and temptation) to reduce its purchases in order to cause a price reduction below the competitive level. In the long run, consumers are not served by such pricing below the competitive level.

This antitrust concern is not raised by a B2B whose participants, in the aggregate, do not represent a large share of the buying market. Certainly at 20% of the buying market, and probably upwards to twice that figure, there should be little or no antitrust anxiety. Even above these levels, it is possible to operate a horizontal buyers' B2B without running into these antitrust dangers, simply by having the buyers *not* aggregate their purchases, but rather negotiating and concluding separate purchasing transactions. This is exactly what the five automobile manufacturers who own and operate Covisint stipulated in advance to do. Prudently, they thus reduced considerably the danger that their jointly owned buyers' B2B would be charged with exercising monopsony power.

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[16] Nonetheless, as discussed earlier in regard to B2Bs, exclusionary practices by a joint purchasing arrangement with market power can create antitrust difficulties. *See*, Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., 472 U.S. 284 (1985). Notwithstanding, the Court acknowledged that, on the whole, "such cooperative arrangements would seem to be 'designed to increase economic efficiency and render markets more, rather than less, competitive.'" *Id.* at 295, citing Broad. Music, Inc. v. CBS, Inc., 44 U.S. 1, at 20 (1979).

III. CONCLUSION

The good news is that in the last 15 years, both courts and enforcement agencies have come to see that, in most instances, horizontal joint ventures and other competitor collaborations have overwhelmingly procompetitive effects. Wise counsel will see to it that such collaborations are structured, and operated in such a way that the procompetitive benefits will flow, free of the anticompetitive features that, if not recognized and guarded against, could provoke lawsuits, government challenges, or even criminal indictments.

APPENDIX A

I. A SUMMARY OF THE ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS[17]

Noting that "a perception [among potential collaborators] that antitrust laws are skeptical about agreements among actual or potential competitors may deter the development of procompetitive collaborations," the U.S. Federal Trade Commission and Department of Justice, Antitrust Division ("the Agencies"), issued *Antitrust Guidelines for Collaborations Among Competitors* ("*Guidelines*") in April, 2000 to "explain how the Agencies analyze certain antitrust issues" raised by horizontal joint ventures, strategic alliances and other competitor collaborations.[18]

The Guidelines do not represent the first effort by the Agencies to provide guidance to the business and legal communities regarding competitor collaborations. Previous efforts include the *Statements of Antitrust Enforcement Policy in Health Care* outlining the Agencies' approach to certain health care collaborations. Additionally, the *Antitrust Guidelines for the Licensing of Intellectual Property* served to outline the Agencies' enforcement policy with respect to intellectual property licensing agreements among competitors. Finally, the *1992 Horizontal Merger Guidelines*, as amended in 1997, outline the Agencies' approach to horizontal mergers and acquisitions, as well as certain competitor collaborations. The Horizontal Merger Guidelines play a significant role in the Collaboration Guidelines, especially in terms of market definition, market power, and market concentration analysis.

A. *Fundamental Principles Influencing the Guidelines, and a Caveat*

Section 2 of the *Guidelines* serves as the Agencies' acknowledgment of the procompetitive benefits that competitor collaborations may offer, as well as the potential anticompetitive harms. While competitors and other businesses are likely to realize the benefits, especially the efficiencies and boost in ability to compete with bigger rivals, they may be less sensitive to the harm to competition and consumers.

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[17] This Appendix was prepared with the able assistance of Stacie R. Hartman, Esq. and J. Carlyle Hearn, Esq. of Schiff Hardin & Waite, Chicago.

[18] *Collaboration Guidelines*, *supra* note 1, at Preamble.

Of particular concern is that the line be as clear as possible between the area of cooperation between competitors and the areas of continuing competition, and that in the latter areas, the participants retain their pricing and marketing independence. The *Guidelines* express a fear that "agreements may limit independent decision making or combine the control of or financial interests in production, key assets, or decisions regarding price, output, or other competitively sensitive variables, or may otherwise reduce the participants' ability or incentive to compete independently."[19] And of course, the closeness and communication appropriately engendered by a legitimate collaboration can also be the occasion for collusion—cooperation and agreements over subjects and products not within the collaboration. Thus, firewalls among individuals and functions within the company, to ensure that sensitive competitive information will not be shared or even available, are crucial to minimizing the danger of "spillover" collusive activity.

In Section 1.3, the *Guidelines* identify certain competitor collaborations that will be analyzed, not under the Collaboration Guidelines, but rather under the Horizontal Merger Guidelines. These are horizontal collaborations in which the agreement eliminates all competition among participants in the relevant market, and where the collaboration does not terminate within a sufficiently limited period under the agreement (usually 10 years).[20] This kind of joint venture or strategic alliance is regarded as sufficiently like a merger in its economic effects as to be treated like one, and analyzed under the Merger Guidelines.

B. *Modes of Analysis in the Guidelines*

The *Guidelines* evaluate competitor collaborations under traditional antitrust principles developed by the courts.

1. Per Se Analysis: Per se illegal agreements are those, like price-fixing, output-restrictions, and horizontal market divisions, which are conclusively presumed to be anticompetitive, without regard to whether, in a particular case, there may be procompetitive benefits. Per se analysis of collaborations is reserved for those that, despite their form, are actually "covers" for such an illegal agreement.

A horizontal agreement among competitors to fix prices or restrict output (or to divide markets, which has the same effect) is

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19 *Id.* at § 2.2.

20 *Id.* at § 1.3.

called a cartel. Cartels determine, centrally or by prior agreement, prices, outputs, or the allocation of customers. They offer no significant prospect of consumer benefit. They are per se illegal under the antitrust laws and can result in heavy fines and imprisonment.

2. Rule of Reason Analysis: Rule of reason analysis focuses on the state of competition in the relevant market, both before and after the proposed agreement or collaboration. The crux of the analysis is whether the net effect of the agreement/collaboration is to harm competition by increasing market power or facilitating collusion; or whether it is procompetitive, such as by creating cost-lowering efficiencies which, in view of continued competition in the market, will be passed on to consumers in the form of lower costs.

"Efficiency-enhancing integration" is often the key to demonstrating a procompetitive justification for a collaborative arrangement. The *Guidelines* provide that in an efficiency-enhancing integration, participants collaborate to perform one or more business functions (such as purchasing, R&D, production, distribution, or marketing) which benefit, or potentially benefit, consumers by expanding output, reducing price, or enhancing quality, service, or innovation. Participants in an efficiency-enhancing integration typically combine, by contract or otherwise, significant capital, technology, or other complementary assets to achieve procompetitive benefits that participants could not achieve separately—as well as to compete more effectively against larger competitors (another procompetitive benefit).

The Agencies will attempt to ascertain the business purpose of an agreement by taking into account inferences that can be drawn from objective facts, especially market facts. Additionally, they will consider evidence of the subjective intent of the participants to the extent that it sheds light on competitive effects. Such evidence of intent may assist in evaluating market power, the likelihood of anticompetitive harm, and the effect on competition post-agreement, particularly where "an agreement's effects are otherwise ambiguous."[21]

Section 3.31(a) of the *Guidelines* focuses on rule of reason analysis of collaborative agreements that may "limit independent decision making or combine control or financial interests" of the collaborating companies, including such agreements pertaining to joint production of goods, joint marketing, buying collaborations, and R&D ventures.

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[21] *Id.* at § 3.31, n.35.

Based on the initial examination as to the nature of the agreement, one of the following three rule of reason frameworks set forth in the *Guidelines* will be applicable to the agreement under review:

1. If the nature of the agreement and the absence of market power demonstrate the absence of anticompetitive harm, the Agencies will not challenge the agreement.[22]
2. "Quick look" or "truncated" rule of reason analysis. If the likelihood of anticompetitive harm is evident from the nature of the agreement, or anticompetitive harm has already occurred, then a challenge is likely without a detailed market analysis. For example, the *Guidelines* cite to *FTC v. Indiana Federation of Dentists*,[23] where the Court condemned - without a detailed market analysis—an agreement among dentists to withhold x-rays from patients' insurers after finding no competitive justification. Recently, in *California Dental Association v. FTC*,[24] the Supreme Court sought to clarify that "quick look" analysis should not be viewed as a separate category of rule of reason analysis. Rather, "the right way to look at 'per se,' 'quick look,' and 'rule of reason' is... simply as different points along a spectrum." The Court further said:

   > [T]here is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint. The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one.[25]

3. "Full blown" rule of reason analysis. If the nature of the agreement indicates possible competitive concerns, which cannot be assessed without a detailed market analysis, the Agencies will analyze the agreement in greater depth. Analyzing

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22 *Id.* at § 3.3.

23 FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 459-60 (1986).

24 California Dental Ass'n. v. FTC, 526 U.S. 756, 781 (1999).

25 *Id.* at 780-81.

the agreement in greater depth will involve a calculation of market shares and concentration along with other factors relevant to the extent to which the participants and the collaboration have the ability and incentive to compete independently.[26]

Where the nature of the agreement and market share and market concentration data reveal a likelihood of competitive harm, the Agencies will continue their analysis by considering other factors relevant to determining, then weighing, the procompetitive and anticompetitive effects of the collaboration, including the following factors:

1. *Exclusivity:* To what extent, and in what manner, does the agreement permit participants to continue to compete against each other and with their joint venture or collaboration?[27]
2. *Control Over Assets:* Does the agreement require participants to contribute significant assets to the collaboration that may prevent, or lessen, the participant from effectively competing in markets affected by the collaboration? For example, if participants in production collaboration must contribute most of their productive capacity to collaboration, the collaboration may impair the ability of its participants to remain effective independent competitors regardless of the terms of the agreement.[28]
3. *Financial Interests in the Collaboration or Other Participants:* The Agencies will assess each participant's financial interest in the collaboration and its potential impact on the participant's incentive to compete independently with the collaboration. Generally, the greater the financial interest in the collaboration (in relation to the participant's remaining financial resources and interests), the less likely the participant will compete with the collaboration.[29]
4. *Control of the Collaboration's Competitively Significant Decision Making:* Generally, a joint venture or collaboration is considered less likely to compete independent of its participants as the participants themselves exercise greater control over the venture's price, output, and other competitively significant

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[26] *Collaboration Guidelines, supra* note 1, at § 3.3.

[27] *Id.*

[28] *Id.* at § 3.34(b).

[29] *Id.* at § 34(c).

decisions. In addition, joint control over the venture's price and output levels could create or increase market power and raise competitive concerns.[30]

5. *Likelihood of Anticompetitive Information Sharing:* The Agencies will evaluate the extent to which competitively sensitive information concerning markets affected by the collaboration would likely be disclosed. The concern is collusion and "spillover effects."[31] A key ingredient is the presence or absence of "firewalls" between individuals and functions to provide structural safeguards against improper information sharing, or collusion.
6. *Duration of the Collaboration:* The duration of the agreement is a factor in determining whether participants will retain the ability and incentive to compete against each other now and in the future. Generally, the shorter the duration, the better, from an antitrust perspective.[32]

If this examination indicates no potential for anticompetitive harm, the Agencies end the inquiry. However, if the picture is mixed, with some pro- and some anticompetitive aspects, the inquiry will go further; specifically, the Agencies will seek to determine whether the agreement will lead to procompetitive "cognizable efficiencies."

Cognizable efficiencies that are verifiable, that do not arise from anticompetitive reductions in output or service, and that cannot be achieved through means less restrictive than those involved in the collaboration.[33] Savings attributable to economies of scale, for example, would be a cognizable efficiency gain.[34]

C. *Safety Zones*

The *Guidelines* have established "safety zones" where anticompetitive harm is deemed so unlikely to occur that the Agencies presume the collaboration to be lawful without inquiring further.

General safety zone: Absent compelling circumstances, a collaboration will not be challenged when the participants' combined market shares going into

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[30] *Id.* at § 3.34(d).
[31] *Id.* at § 3.34(e).
[32] *Id.* at § 3.34(f).
[33] *Id.* at § 3.36.
[34] *Id.*

the collaboration account for no more than twenty percent (20%) of the relevant market.[35]

R&D safety zone: Generally speaking, bona fide R&D collaborations will be safe from antitrust challenge where at least three other, independently-controlled R&D efforts exist that could serve as a substitute for the collaborative R&D activity in question.[36]

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35 *Id.* at § 4.2 (emphasis added).

36 *Id.* at § 4.3.

APPENDIX B:

I. ANTITRUST TREATMENT OF JOINT VENTURES UNDER EU LAW[37]

European Union (EU) competition law is concerned with "undertakings"[38] in the public and private sectors of European society. EU competition policy is established by the European Commission, which is empowered to render decisions on whether certain commercial arrangements will create or strengthen a dominant position for the entities under consideration, thus impeding effective competition.

EU competition law addresses joint ventures and strategic alliances primarily under: 1) the EC Merger Control Regulation ("the Merger Regulation") and 2) Article 81 of the EC Treaty ("Article 81" or "the Treaty"). With respect to Article 81, the Commission is empowered to "ensure the application of the principles" of Article 81 by investigating, on its own initiative or by application of a Member State, any suspected violation. Which of these provisions will govern a commercial arrangement depends largely on the specific character of the arrangement.

A. *Joint Ventures and Strategic Alliances: General Characteristics*

1. JOINT VENTURES

EU competition law recognizes several classifications of joint ventures, depending on specific characteristics of the joint venture. The classification of the joint venture will dictate both its procedural and substantive legal treatment.

a) *Concentrative "full-function" joint ventures*: Joint ventures that perform on a lasting basis all the functions of an autonomous economic entity. Typically, such a venture is a separate corporate entity from its parents/co-venturers, and has sufficient management, finance, staff, and other resources to conduct business on a long-term basis. These are often referred to as

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[37] This Appendix was prepared with the able assistance of Manotti L. Jenkins, Esq. of Schiff Hardin & Waite, Chicago.

[38] An "undertaking" is a broad concept under EU competition law. It applies to any collection of resources for economic purposes, including a company, partnership, a proprietorship, or an association.

"merger-type" joint ventures that have a community dimension, because their "turnovers"[39] exceed certain thresholds established under the relevant provision.

b) *Cooperative "full-function" joint ventures*: Joint ventures which perform on a lasting basis all the functions of an autonomous economic entity, but *do not* have a "Community dimension;" *i.e.*, their turnovers do not exceed the established thresholds.

c) *Cooperative "partial-function" joint ventures*: Joint ventures that perform only limited, specific functions (*e.g.*, research & development, production, joint distribution, or joint purchasing activities for their parents) and have no access to a market. Also, joint ventures which are established for a short duration, *e.g.*, those designed to construct a specific project, will be classified under this heading, because they are considered as *not* operating on a lasting basis. These joint ventures will be treated as merely auxiliary to their parents. These may or may not have a community dimension.

2. STRATEGIC ALLIANCES

EU competition law recognizes a strategic alliance as a form of cooperation between firms–commonly with competing or complementary skills–which do not establish a separate business entity. Strategic alliances provide for a legally structured framework designed to promote synergy and closer cooperation for technical, operational and/or commercial means.

As cooperative arrangements, strategic alliances can be of varying scope. They usually involve the creation of several contractual or structural links, *e.g.*, the creation of a "contractual" joint venture, specializing in certain markets, joint R&D, technology transfer, cross-supply arrangements, commitments to cooperate in other fields in the future, and the acquisition of shareholdings.

Generally, strategic alliances are limited to a specific field of the parties' activities, such as the development and introduction of new technology, or cooperation on the frequency and modalities of services (as in airline flights or telecommunication services). Strategic alliances are generally forged between actual competitors and often aim at initiating a new form of competition with other, similar alliances in response to the growing integration of markets. In particular, strategic alliances often surface in EU

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[39] "Turnover" is the amount of business done by an undertaking or group of undertakings, measured in the European Community by ECUs.

markets that have been liberalized, such as air transport and telecommunications.

The primary competitive concern with both joint ventures and strategic alliances is ensuring independence and effective competition between the otherwise competing companies, so that the procompetitive benefits of the alliance can be realized without the anticompetitive costs of cartel behavior.

B. *Applicable EU Competition Law*

1. **THE MERGER REGULATION**

The Merger Regulation applies to *concentrative full-function joint ventures* ("merger-type" joint ventures) above a certain size.[40] The Commission must be notified with seven days of a binding agreement, but before implementation, in such a venture("mandatory notification"). The information required in the notification is substantial and takes considerable time to prepare; certain Commission best-practice guidelines suggest "informal meetings" one to two weeks in advance of notification. The joint venture cannot go forward until the Commission approves.

The initial investigation period is one month, or six weeks under certain circumstances (*e.g.*, when the parties offer commitments to the Commission in response to any competitive concerns); if the proposed deal raises danger flags to the Commission, the Commission may decide to initiate an investigation which could last up to an additional four months.

Substantively, the Merger Regulation assesses joint ventures falling under its ambit to determine: 1) whether the joint venture creates or strengthens a dominant position which could result in the significant impeding of effective competition;[41] and 2) if the parties are competitors with each other or with the joint venture in markets related to the joint venture's business, whether the joint venture will result in collusion in those related markets.[42]

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[40] *See generally*, *Merger Guidelines*, *supra* note 4. Article 1 contains rather elaborate size requirements, based on sales or "turnover" thresholds. Basically, the Merger Regulation applies to "all concentrations with a Community dimension," meaning an aggregate worldwide turnover of more than ECU 5,000 million (5 billion), and an aggregate Community-wide turnover of each of at least two of the undertakings of more than ECU 250 million. However, there are various carve-outs, and an alternative test as well, so the technical definitions must be carefully consulted. Even "turnover" has a technical definition, which appears in Article 5.

[41] *Merger Guidelines*, *supra* note 4, at Article 2(1).

[42] *Id.* at Article 2(4).

A summary of the recent EU treatment of the joint venture between British Telephone ("BT") and AT&T is illustrative of several aspects of antitrust joint venture analysis in Europe. On March 30, 1999, the Commission conditionally approved the operation of a concentrative full-function joint venture, owned 50-50 by BT (the fifth largest telecommunications operator worldwide by turnover) and AT&T (the second largest). The joint venture would provide a broad range of advanced global telecommunications services to multinational corporate customers and international carrier services to other carriers.

The Commission analyzed the joint venture as it affected four different markets: global telecommunications services, international carrier services, international voice telephony services on the UK-US route, and certain UK services.

> a) *Global communications.* The Commission investigated whether there were any bottlenecks that would constitute barriers to entry for new entrants or whether the joint venture would benefit from unmatchable advantages; also, whether BT's current strong position on the local loop in the UK, and the possibilities of the joint venture locking in customers by the API facilities, would create a dominant, competition impeding position in the common market. The Commission concluded that both competitors and customers would react swiftly to price increases, so that such increases above the competitive level would not be profitable for the joint venture.
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> b) *International carrier services.* Following an investigation, the Commission concluded that the joint venture would not lead to the creation or strengthening of a dominant position in the area of international carrier services. The Commission based its conclusion on the fact that competition is strong and will be at least as strong after the venture as before: new competitors have entered the market, volumes of international traffic carried by these parties is matched by volumes carried by remaining competitors, there is no lack of capacity either in the EU or on transatlantic routes, and the cost of capacity is decreasing rapidly.
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> c) *International voice telephony services on the UK-US route.* Although the capacity owned by the joint venture on all transatlantic cables would be less than 20% in 2000, it appeared to the Commission that the joint venture would account for approximately half of the two-way traffic between the US and the UK. Thus, the Commission conducted a more thorough investigation. The Commission determined, based on the follow-up investigation, that the joint venture would not be able either to raise its competitors'

costs or to act independently from its competitors and customers. The Commission based this conclusion on the facts that numerous facilities-based operators are authorized to operate on the US-UK route, several operators have already started to own end-to-end capacity, and because of the availability of excess capacity at rapidly decreasing costs.

d) *Certain UK services.* The Commission investigated the possibility that creation of the joint venture would strengthen BT's dominant position on certain UK markets for telecommunications services. The Commission found that the current and future regulatory regime to be applied by the UK telecommunications regulator would prevent BT from adopting such behavior.

2. ARTICLE 81 OF THE TREATY

Article 81 applies to joint ventures that are not merger-type ventures, i.e., to *cooperative full-function joint ventures*, *cooperative partial-function joint ventures*, and *strategic alliances*. Notification to the Commission is not required (but may be prudent), and if approval is sought, there is no need to suspend the venture or strategic alliance pending approval. However, the Commission decision-making process tends to take longer under Article 81.

If the arrangement is likely to be challenged as restrictive of competition, it might be wise to consider applying for an exemption. Article 81(3) allows for exemptions of arrangements if certain beneficial characteristics are shown, *e.g.*, increased efficiency in the production or distribution of goods, ensuring that a fair share of the benefits are passed on to consumers, avoiding restrictions which are not indispensable for achieving benefits, and providing safeguards against collusion or joint activity that may reduce or eliminate competition. Strategic alliances often obtain exemptions because of their efficiency-enhancing effects, enabling the parties to compete more effectively with other alliances or larger companies, particularly where the line between spheres of cooperation and noncooperation is clearly drawn.

In contrast to the approval under the Merger Regulation, any exemption under Article 81(3) would be for a limited time, after which the arrangement would be re-assessed. Absent an exemption, an arrangement found to be anticompetitive may be voided, private parties harmed by the agreement may sue in court, and the Commission may impose fines.

Substantively, the Commission will consider whether the arrangement will have an appreciable anticompetitive effect. To grant an exemption, the Commission must conclude that the beneficial effects of the arrangement under consideration outweigh its anticompetitive impact.

Let us consider, for illustrative purposes, a significant recent decision by the Commission under Article 81 of the Treaty, namely, the strategic alliance among Lufthansa Airlines, SAS, and United Airlines. In August 1996, these three airlines concluded a coordination agreement aimed at establishing a worldwide alliance, including code-sharing and other cooperative arrangements aimed at facilitating intercompany access by international passengers. This followed two bilateral agreements, one between Lufthansa and United (concluded on January 9, 1996) and one between SAS and United (concluded on June 28, 1996). The Commission, on July 3, 1996, decided to initiate separate proceedings aimed at each of the bilateral agreements. On September 18, 1996, the Commission initiated the same proceedings with respect to the coordination among all three airlines. The Commission preliminarily concluded that the agreements violated Article 81, then it issued a proposal outlining its analysis and setting out appropriate measures to alleviate the violation. The Commission analyzed the agreements only in connection with the transport of passengers.

The Commission's conditions for approval of the alliance included the following:

a) The members of the alliance were required to reduce their combined flight frequencies, upon competitor request, under certain conditions.
b) The members of the alliance were required to make slots available to airlines authorized to provide services between Frankfurt or Copenhagen and the United States, on request, with certain conditions. The slots were to be made available in Frankfurt or Copenhagen.
c) Lufthansa was required to terminate its code-sharing agreement with Lauda Air on the Vienna-Munich-Miami route.
d) The members were given two options regarding their frequent flyer programs ("FFPs"): either (1) refrain from pooling their FFPs in connection with travel between Germany and Scandinavia, respectively, and the United States, and refrain from allowing passengers to transfer program points obtained in the FFP of one member of the alliance to that of another member; or (2) allow airlines without comparable FFPs to participate in the joint FFP of the alliance, while preserving confidentiality of transferred data.
e) The alliance was required to ensure that its joint policy toward travel agents established or providing services in Germany not include a system of remuneration that has the object or effect of securing the loyalty of travel agents to the members of the

alliance in the relevant markets. In addition, the terms of fares offered to large customers established or buying transport services in Germany should be linked to annual turnover in the relevant markets, without a system of thresholds or a system that directly or indirectly rewards loyalty.

f) Any airline established in a European member country or in the United States, which operates services on one or more of the relevant routes, should be entitled to ask for an interlining agreement with the members of the alliance. The members were required to conclude the agreement on the terms usual in the industry.

g) The Member States of the EU (plus Norway) were required to authorize any established carrier in the European Community to operate direct and indirect services between any airport in their territory and the United States. The U.S. authorities were required to authorize the operation of those flights to an extent sufficient to ensure that the alliance cannot eliminate competition in a substantial portion of the relevant markets.