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A SPECIAL REPORT

In hard times, companies look to joint ventures

These competitor collaborations pose a range of antitrust issues that must be fully understood.

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The U.S. Federal Reserve reports that manufacturing output and capacity utilization this past summer were at their lowest levels in more than 60 years. These unprecedented economic pressures have forced executives to examine every available option to restore profitability, at a time when raising prices is an unlikely path forward. In response, strategic deal-making has increased, with greater focus on joint ventures—rather than complete takeovers—as a solution to the current economic conditions. Joint ventures (JVs), or competitor collaborations, can cover a range of activities, from research and development (R&D) at one end to all-in JVs at the other. These different forms of collaboration and consolidation pose a range of antitrust issues that need to be fully understood to assess the total costs and benefits of any planned restructuring.

R&D collaborations can efficiently combine resources to respond to a range of external factors, such as the need to comply with new regulatory requirements (e.g., environmental or safety) or to invent around unprecedented input cost changes. These collaborations allow venture partners to share risk and combine complementary assets and technologies, and to facilitate R&D that would not otherwise be undertaken. They may also quicken the pace of innovation. The United States has long recognized that such collaborations can promote efficiency, and in 1984 Congress enacted the National Cooperative Research Act, 15 U.S.C. 4301-02, to mandate "rule of reason" treatment under § 1 of the Sherman Act for R&D JVs.

But these collaborations can also raise antitrust risks, as past government enforcement illustrates. See, e.g., *U.S. v. Automobile Manufacturers Ass'n*, 1969 Trade Cas. (CCH) ¶ 72,902 (C.D. Calif. 1969); Federal Trade Commission and U.S. Department of Justice, Antitrust Guidelines for Collaborations Among Competitors (April 2000). Specifically, R&D collaborations can retard the pace of innovation by eliminating rivalry and can lead to spillover effects that limit competition among the collaborators in downstream product markets. See Collaboration Guidelines §§ 3.31(a), (b). The former concern requires analysis that there remain sufficient participants outside the collaboration to provide adequate competition; the latter problem can be managed through the appropriate use of firewalls.

As companies move beyond R&D and consider collaborations that include production assets, the nature of the antitrust risks—and the mode of analysis—change.

PRODUCTION JVs

Production JVs can be categorized by the extent of the parties' integration. At one end of the spectrum, an existing producer can enter into a contract or toll manufacturing arrangement with a competitor whereby the competitor will be the sole producer, enabling the first company to shut down its own capacity and reduce cost. Such manufacturing agreements, however, create both business and antitrust risks: The purchasing company becomes dependent on its competitor for supply, and the buy/sell arrangement necessitates regular communications between two companies that compete downstream. The antitrust risk can be managed with appropriate firewalls and training, but the business risk may be more difficult to address.

One potential answer is the formation of a more fully integrated production JV. A production JV can allow the partners to align their combined manufacturing capacity to match the reduced demand (i.e., if each is

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running at 50% capacity, loading all demand onto one plant will reduce unit production costs), or may support construction of a new, more efficient plant that neither partner would undertake on its own. In either case, because the JV is limited to production, customers continue to have the benefit of two independent competitors in the marketplace.

Congress recognized that production JVs typically are pro-competitive and, in 1993, amended the National Cooperative Research Act of 1984 to include production JVs. National Cooperative Production Amendments of 1993, Pub. L. No. 103-42. Despite these pro-competitive effects, the agencies have flagged various areas of concern for production JVs, including the loss of competition between the companies as producers; transfer pricing from the JV that, if too high, can raise participants' marginal costs and reduce competition in the sale of the JV output; agreements to limit the JV's output; agreements to limit competition in the resale of the output; and impermissible information flows. See Collaboration Guidelines § 3.31(a). None of these issues presents insurmountable obstacles, but the history of antitrust enforcement indicates that JVs have been the source of antitrust problems, and therefore the real antitrust risks often arise once the JV is formed and begins operations.

At the other end of the spectrum is the "all-in" JV, which combines not only production but marketing and sales as well. This was the approach taken by the Shell Oil Co. and Texaco in their Motiva and Equilon JVs. The formation of these JVs was approved by the Federal Trade Commission, but their activities were challenged in private litigation. Ultimately, in *Texaco v. Dagher*, 547 U.S. 1 (2006), the U.S. Supreme Court rejected the plaintiff's claim that the parent companies' agreement to set the price of the venture's output constituted a per se violation of the antitrust laws. Rather, the Court found that, because each parent company had contributed all of its capacity to a legitimate, fully integrated JV, the formation of which had passed antitrust muster, the parent companies were no longer competitors, so the challenged pricing agreement was properly subject to rule-of-reason analysis.

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RISKS OF ALL-IN JVs

Although it would be natural to assume that the complete acquisition of a competitor would raise the greatest antitrust risk, the all-in JV actually is riskier. These ventures raise issues not only regarding their creation but also regarding any on-going communications between the JV partners and other operational aspects of the JV itself. In short, there are greater opportunities to get into antitrust mischief in a JV context as compared to a complete acquisition, when the antitrust risk generally is presented only once.

In preparing any of the above scenarios for possible antitrust review, companies will want to be mindful of the Obama administration's announced positions on strengthened antitrust enforcement generally and on the interplay of antitrust and the economic crisis in particular. Despite the sharp drop in merger activity, the Obama administration antitrust agencies have already challenged 10 transactions notified under the Hart-Scott-Rodino Act, as well as three previously consummated mergers. And in September, the agencies jointly announced a series of workshops to assess possible changes to the Horizontal Merger Guidelines. Without prejudging the outcome of that exercise, some of the questions that the agencies have advanced for consideration—such as whether competitive harm can be proven directly, without the need to establish the contours of relevant markets—indicate that they are looking to amend the Merger Guidelines in ways that will make it easier to secure enforcement victories in the courts.

Turning specifically to the issue of merger enforcement and the economy, Commissioner J. Thomas Rosch has said that "competition laws need to be implemented at least as strictly during a time of economic crisis as they are otherwise." See J. Thomas Rosch, "Implications of the Financial Meltdown for the FTC," Address at the New York Bar Association Annual Dinner (Jan. 29, 2009).

That said, parties to competitor collaborations still have an array of tools available to them. Perhaps the most important is the Supreme Court's last merger decision, *U.S. v. General Dynamics Corp.*, 415 U.S. 486 (1974), which stressed that Clayton Act § 7 merger analysis must focus on a company's future ability to compete, not its past competitive significance. See id. at 494-504. General Dynamics' arguments may prove quite effective when, as now, the economic downturn has radically altered the competitive landscape in many industries and weakened once formidable competitors. And, while the threshold for proving a true failing company or division remains high, the current economic times may allow companies to establish a failing-company or, at a minimum, an exiting-assets, defense.

Parties considering competitor collaborations need to be mindful that the antitrust agencies will stick to balancing the efficiencies from the proposed collaboration against the harms to competition and customers, and they need to prepare their case accordingly. Guidance from the antitrust agencies as to how antitrust laws apply to collaborations, and specifically when there is sufficient integration that the collaborators are no longer competitors, can be found in the recently filed amicus brief of the United States in *American Needle Inc. v. National Football League*, No. 08-661 (Sept. 25, 2009). Among other points, the antitrust agencies note that collaborators can be a single economic actor for some purposes and competitors for others. *American Needle* is likely to add substantively to the antitrust analysis of competitor collaborations, and it bears continued attention by the business community and the antitrust bar.

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