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THE LEGAL STATUS OF JOINT VENTURES UNDER THE ANTITRUST LAWS: A SUMMARY ASSESSMENT

by

JOSEPH F. BRODLEY*

The spotlight of enforcement interest has begun to focus more intensely on one of the darkest corners of antitrust law—joint ventures. The enforcement agencies have in recent years instituted a number of actions against joint ventures,¹ and the House Judiciary Committee this year opened an investigation of joint ventures in the petroleum industry.²

Precisely because the legal precedents are few and large areas of uncertainty remain, it seems desirable to set down as clearly and succinctly as possible what it is that can and cannot be said about the law of joint ventures.³ Since my

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¹ *United States v. N. Y. Times Co.*, Civil Action No. 71C615 (E.D.N.Y., filed May 21, 1971); *United States v. Hercules Inc.*, Civil Action No. 4667 (D. Del., filed May 31, 1973); *Phillips Petroleum Co.*, 3 CCH Trade Reg. Rep. at 25,736 (F.T.C. Consent Order, August 2, 1966); *Rexall Drug and Chemical Co.*, 3 CCH Trade Reg. Rep. at 25,742 (F.T.C. Consent Order, October 11, 1967); *Brunswick Corp.*, 3 CCH Trade Reg. Rep. ¶20,887 (F.T.C. Complaint).

² *Hearings on the General Legal and Economic Implications of Joint Ventures Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary*, 94th Cong., 2d Sess. (February 11, 1976 and subsequent dates).

³ The following secondary sources have been particularly useful: R. Pitofsky, *Joint Ventures Under the Antitrust Laws: Some Reflections on the Significance of Penn-Olin*, 82 HARV. L. REV. 1007 (1969); C. KAYSEN & D. TURNER, ANTITRUST POLICY 136-141 (1959); W. Mead, *The Competitive Significance of Joint Ventures*, 12 ANTI-TRUST BULL. 819 (1967); J. Pfeffer & P. Nowak, *Patterns of Joint*

objective is to discover predictive standards for ascertaining the lawfulness of joint ventures, I place particular emphasis on what courts have done as distinct from their sometimes obscure explanatory language. We may be surprised to find that there is more settled law than at first suspected.

The very definition of a joint venture is unclear. More than a simple contract yet less than a merger, it remains a hybrid legal form. Perhaps the key element is continuity, and the most useful definition is that of Taubman, who defines a joint venture as an "association of two or more persons to carry on as co-owners an enterprise for one or a series of transactions."⁴ While the typical joint venture is a jointly owned subsidiary corporation, it is not essential under this definition that either the parents or the joint venture be corporations.

The decided cases have arisen either under the Sherman Act or the antimerger provisions of the Clayton Act; in addition the Federal Trade Commission has alleged, in a recent complaint, violation of Section 5 of the FTC Act.⁵ Brief reference will also be made to certain issues not appearing in the legal decisions, which may in the future assume greater importance. I turn first to the status of joint ventures under the Sherman Act, where the bulk of the cases have arisen.

JOINT VENTURES UNDER THE SHERMAN ACT

The courts have found a variety of joint ventures to be unlawful restraints of trade under Section 1 of the Sherman

Venture Activity: Implications for Antitrust Policy (forthcoming); J. Brodley, *Oligopoly Power Under the Sherman and Clayton Acts—From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285, 329-337 (1967).

⁴ TAUBMAN, THE JOINT VENTURE AND TAX CLASSIFICATION 83 (1957).

⁵ *Continental Oil Co.*, 3 CCH Trade Reg. Rep. at 25,743 (F.T.C. Consent Order, November 21, 1967).

Act. Where a joint venture tainted under Section 1 has involved all or most of the firms in an industry, it has generally been found to violate the monopolization provisions of Section 2 of the Act, as well.

The anticompetitive abuses which have arisen in the Sherman Act cases have been of two basic types: (1) cartel behavior, and (2) boycotts and exclusion of competitors. In the cartel cases the joint venture has been used as a means of restraining competition between the participants, typically by fixing prices and dividing markets, thus depriving the public of the benefits of competition.

In the boycott cases the joint venture has excluded firms from participating in the joint venture, thereby depriving them of a vital resource and crippling their ability to compete with joint venture participants. The evil has been to diminish the overall vigor of competition as well as reduce equality of economic opportunity by injuring and handicapping a portion of the competing units.

Predictive factors useful in explaining the decisions of the courts involving cartel behavior under the Sherman Act appear to be the following, stated roughly in order of importance:

1. Whether the joint venture stands in a horizontal, vertical or conglomerate relationship to the parents' market, i.e. whether (a) the joint venture competes in the same market as one or both parents, or (b) is a seller to or buyer from the parents, or (c) there is no obvious relation between the joint venture and the market of either parent.
2. The presence of a *per se* restraint of trade in connection with the marketing activities of the joint venture.
3. The holding of high market share by the parents or by the joint venture.
4. The purpose of the joint venture.

It will be useful to divide the discussion under the separate categories, horizontal, vertical and conglomerate joint ventures. This also accords with the recognized seriousness of the competitive risk and the frequency of the cases. I turn first to horizontal joint ventures, by far the most prevalent situation in the case law.

Horizontal Joint Ventures

The horizontal joint venture raises essentially a problem of cartel abuse. Where the joint venture competes in the same field with the parent, the interests of both are apt to be served by suppressing competition between them. Typically, this has involved price fixing or division of the market. While such behavior could occur on either the buying or selling side of the parents' operations, the cases have focused their attack on joint ventures that involved restraints on the sale and distribution of the parents' output. A joint venture may be horizontal as to one parent and vertical or conglomerate as to the other, and this may necessitate analysis under the other categories as well, but here we focus on the horizontal.

Horizontal joint ventures themselves fall into two basic types: (1) the parents may create a joint venture to assume control of some present portion of their existing competitive operations, or (2) the parents may create a joint venture to enter a new geographic market.

JOINT VENTURES BETWEEN EXISTING COMPETITORS IN EXISTING MARKETS

The transfer by direct competitors of some portion of their existing operations to a joint venture is obviously suspect, for they have placed under unitary control, activities which were previously separate and competitive. In this situation certain rather definite generalizations can be drawn from the case law.

First: *Sherman Act* illegality has always rested on a *per se* violation involving the marketing of the product. What-

ever the character of the joint venture the Sherman Act cases have rested on a per se violation of the Act involving the marketing of the product. Where the joint venture is horizontal, the per se violation has been price fixing or division of the market between competitors. Such per se violation may be inherent in the very existence of the joint venture or collateral to its operations. The violation was inherent in *Citizens Publishing Co. v. United States*⁶ where two newspapers serving the same market, the one profitable, the other losing money, sought to operate a joint venture to achieve economies of production and distribution while keeping news and editorial operations separate. The Supreme Court found the illegality under the Sherman Act "plain and beyond peradventure" since profits would be pooled and prices fixed by the joint venture.⁷

The antitrust violation in *Citizens Publishing Co.* also had a collateral aspect in the agreement by the parents not to create any other competing entity in the joint venture market. Whether the violation is inherent or collateral, however, does not affect the illegality, though it may have bearing on the remedy to be given. It is the presence of a per se violation connected with the joint venture that is crucial to illegality.

Second: *Where the per se violation has involved a joint venture between competitors holding a large market share, not only has antitrust illegality almost inevitably been found but the typical relief has included dissolution of the joint venture.* The views of courts concerning the inherent antitrust danger of a horizontal joint venture have clearly been related to the share of the market held by the parents. Thus in each of the four previously cited cases, *Citizens Publishing Co.*, *Lee Line Steamer*, *ICI* and *Paramount*, where the par-

⁶ 394 U.S. 131 (1969).

⁷ See also *Lee Line Steamer v. Memphis H & R Packet Co.*, 277 F. 5 (6th Cir. 1922); *United States v. Imperial Chemical Industries*, 100 F. Supp. 504 (S.D.N.Y. 1951); *United States v. Paramount Pictures*, 334 U.S. 131 (1948).

ents together held all or most of the market, the courts would tolerate no relief short of dissolution of the offending joint ventures; for where firms dominating a market have utilized a joint venture to commit a per se violation of the antitrust laws in the words of the *ICI* court, any continuance of joint ownership "provides an ever present opportunity for further wrong doing."⁸

Third: *Where the joint venture is between smaller competitors not collectively holding a dominant market share, the presence of per se violations will lead to injunction of the unlawful practices but not dissolution of the joint venture if there is a legitimate purpose for its existence.*

Where the parents do not hold a commanding share of the market, the courts seem clearly to feel that the antitrust risk in continued existence of the joint venture is more tolerable. While this leads to no toleration of per se violations, it does lead to willingness to grant relief short of joint venture dissolution.

Two recent Supreme Court cases, *United States v. Sealy, Inc.*⁹ and *United States v. Topco Associates*,¹⁰ both involved joint ventures by smaller firms facing significant competition. Rejecting the argument that price fixing and division of the market were necessary to achieve desirable goals, including effective competition with larger firms in *Topco*, the Court condemned the per se violations involved in the marketing of the products. However, in neither case did the Court require the dissolution of the joint venture, there being other legitimate purposes for its existence. The importance of the last condition as a decisional factor, i.e. the finding of legitimate business purpose, should not be exaggerated, for it would be a rare management that could not point to some efficiency-promoting or other legitimate purpose in a com-

⁸ 105 F. Supp. 215, 236 (S.D.N.Y. 1952 (remedial proceeding)).

⁹ 388 U.S. 350 (1967).

¹⁰ 405 U.S. 596 (1972).

plex business arrangement such as a joint venture. Thus, the key factor in these cases is the relatively small market share held by the parents.

JOINT VENTURES INTO NEW GEOGRAPHIC MARKETS

Where firms producing the same product form a joint venture to enter a new geographic market, the impact on competition is less immediate and direct. Indeed, since prior to the joint venture the parents had no presence at all in the new market, the immediate effect would appear procompetitive. However, taking a somewhat longer range view as discussed below, the courts have held that where the joint venture involves major sellers in concentrated world markets, creation of the joint venture may foreclose a more competitive alternative, individual entry by the parents. Under these circumstances, the joint venture serves as a means of dividing the market between the parents. The following generalizations seem appropriate under the case law.

First: Where both parents are major producers collectively holding a dominant market position, their entry into a new geographic market by a joint venture which encompasses the marketing of that product has been held to be an unlawful division of the market between competitors; and the most frequent relief has been the dissolution of the joint venture.

Where a joint venture forecloses independent entry by the parents, into a new geographic market, the injury to competition is best described as an injury to potential competition. As an issue in recent decisions under Section 7 of the Clayton Act, potential competition has raised difficult problems of proving what would have happened on hypothetical facts, and this has clouded the interpretation of the law and impeded effective enforcement.¹¹ In the Sherman Act cases involving joint ventures between major producers holding

¹¹ See *United States v. Marine Bancorporation*, 418 U.S. 602 (1974); *United States v. Penn-Olin Chemical Corp.*, 378 U.S. 158 (1964); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973).

dominant market positions, however, the courts have avoided these problems by simply assuming that in the absence of the joint venture the probability of independent entry by one or both parents was high. The courts reached this conclusion not on the basis of complex analysis, but from the simple logic of the parents' business posture and their economic interest, which formulation of the joint venture evidenced, in entering the new geographic market. Indeed, injury to potential competition under these circumstances was virtually equated to an injury to actual competition. This was perhaps most vividly expressed by the *General Dyestuff* court, which in dismissing the argument that the parents, both among the largest manufacturers of the product, had not previously been in competition, said, "Neither the letter of the law nor its purpose 'distinguishes between strangling a commerce which has been born and preventing the birth of a commerce which does not exist.'" ¹²

The essence of the offense then is that two or more firms on the verge of market entry withdraw in favor of a joint venture and thereby divide the market between them.¹³ In *National Lead* and *Minnesota Mining* the courts required the dissolution of the joint venture, while in *Timken* a divided Supreme Court deemed an injunction prohibiting agreement by parent or progeny to limit territory, to be sufficient.¹⁴

Involving as it does a per se offense, a joint venture used as an instrumentality to divide the market between competi-

¹² *United States v. General Dyestuff Corp.*, 57 F. Supp. 642, 648 (S.D.N.Y. 1944), quoting *United States v. United Shoe Machinery Co.*, 247 U.S. 32, 53 (1918).

¹³ See *United States v. National Lead*, 63 F. Supp. 513 (S.D.N.Y. 1945), modified & aff'd, 332 U.S. 319 (1947); *United States v. Minnesota Mining & Mfg. Co.*, 92 F. Supp. 947 (D. Mass. 1950); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

¹⁴ The Court noted, however, that one of the parents had recently become empowered to exercise an option to buy out the other parent, which atypically was a natural person, recently deceased, so that there was some probability that the joint venture might eventually dissolve of its own weight. 341 U.S. at 601, n.10.

tors cannot be saved by the existence of a claimed "legitimate purpose" motivating its creation. The Supreme Court makes this unmistakably clear in *Timken*, in rejecting the defendants' argument that the restraints were lawful as ancillary to a "legitimate main transaction," i.e. the joint venture:

We cannot accept the "joint venture" contention. That the trade restraints were merely incidental to an otherwise legitimate "joint venture" is, to say the least, doubtful. The District Court found that the dominant purpose of the restrictive agreements into which appellant, British Timken and French Timken entered was to avoid all competition either among themselves or with others. *Regardless of this, however, appellant's argument must be rejected.* Our prior decisions plainly establish that agreements providing for an aggregation of trade restraints such as those existing in this case are illegal under the Act. (Emphasis supplied.)¹⁵

Second: *Where only one parent is a producer in the same product line as the joint venture, and where the parties have large market shares, precedent exists for holding unlawful an agreement or other restraint on the territorial operations of the joint venture.*

Where only one of the parents produces the product, there is much less basis for assuming that in the absence of the joint venture *both* parents would have entered the new geographic market. More likely there would have been at most a single market entry, and hence a case of injury to potential competition is difficult to make out. The competitive risk lies not in the existence of the joint venture, but in limitations that may be placed on its development. The risks are also less severe when only one of the parents is in the joint venture's product market because the outside-the-market parent has financial incentive to push for full exploitation of the joint venture's profit potential even at the expense of the

¹⁵ 341 U.S. at 597-98.

profits of the inside-the-market parent. Thus, the anticompetitive risk is apt to depend explicitly on the presence of particular restrictions on the activities of the joint venture.

The *Panagra* case¹⁶ illustrates just such a situation. The joint venture in that case, a South American airline called Panagra, was potentially competitive in its product line with only one of the parents, Pan American Airways. The restriction on the joint venture was in the form of a veto power by Pan American based on its 50% stock ownership in the joint venture, which it had exercised to preclude the Panagra joint venture from flying routes competitive with Pan American. In the context of the dominant position that Panagra and Pan American held in air transportation in their respective west and east coast markets in South America, the court condemned Pan American's conduct as violating Section 2 of the Sherman Act and ordered divestment of its interest in the joint venture. The court expressly declined, however, to find the original creation of the joint venture and territorial allocation between the two airlines 20 years earlier when both were small new enterprises, to be unlawful; for at that time the joint venture and territorial restrictions, were a necessary, even desirable, vehicle for pioneering a new market.

Thus, the teaching in *Panagra* goes no farther than to suggest that when both parent and joint venture become dominant firms in their separate geographic markets, any territorial (or other significant) restrictions on their competitive interaction is apt to be held unlawful. The limited reach of the Sherman Act precedents is further illustrated by the lower court opinion in *Cellophane*.¹⁷ The district court in *Cellophane* specifically upheld territorial restrictions confining the geographic markets of the joint venture to preclude

¹⁶ *United States v. Pan American World Airways*, 193 F. Supp. 18 (S.D.N.Y. 1961), *rev'd on other grounds*, 371 U.S. 296 (1963).

¹⁷ *United States v. E. I. duPont*, 118 F. Supp. 41, 218-222 (D. Del. 1953), *aff'd* 351 U.S. 377 (1956).

competition between the parent foreign producer of cellophane and the joint venture established in the then unexploited United States market. While the vitality of the district court decision is at least questionable, the Supreme Court having refrained in its affirming opinion from even mentioning the lower court's views on the joint venture agreement,¹⁸ the decision clearly provides no precedent for Sherman Act illegality.

Thus, based on very limited authority, the law appears unclear as to the validity under the Sherman Act of territorial divisions of the market between a *single* parent producing the product elsewhere even if it is the dominant producer, and a *newly established* joint venture in a new geographic market. But *Panagra* indicates that when and if the joint venture achieves market power, any such arrangements are subject to critical reassessment.

OTHER HORIZONTAL JOINT VENTURES

The class of horizontal joint ventures clearly and predictably unlawful under the Sherman Act is thus relatively narrow. What is the status of other horizontal joint ventures? More particularly what is the status of horizontal joint ventures within existing markets which (1) do not involve explicit price fixing or division of the market between competitors, or (2) involve price fixing or market division on the supply side of the parents' operations rather than on the marketing side? (We temporarily put to one side problems of boycott or exclusion of firms from the joint venture, to be discussed in the next section.)

The accepted learning is that the broad class of other joint ventures, like business transactions in general, are sub-

¹⁸ See 351 U.S. at 383. The issue may have been considered moot. The Supreme Court noted that duPont itself raised legal questions as to at least a portion of the territorial restrictions and notified foreign licensees as early as 1940 that license agreements were not to be read as imposing territorial restrictions. Moreover, the district court's own decision had also rested on an independent ground—assignment of trade secret rights. 118 F. Supp. at 218-222.

ject to the rule of reason. The fact is, I have not found reported decisions of joint venture illegality unless a per se violation appears (though courts may sometimes describe their inquiry as under the rule of reason).¹⁹ The lack of significant joint venture enforcement activity based on the rule of reason does not surprise me, for it accords with a long standing bias on my part. The limits of effective antitrust enforcement are by and large coterminous with the limits of its per se rules. The rule of reason, calling as it does for a consideration of all facts—or to exaggerate only slightly, all evidence that either party thinks relevant—is to be blunt an ineffective tool for antitrust enforcement. It can provide no viable basis for effective enforcement policy because it lacks predictive power where as in antitrust cases the facts are (1) highly complex, (2) necessarily differing in significant respects from case to case, (3) subject to litigation by parties possessing large resources and incentives, and (4) submitted for trial to nonexpert, heavily engaged trial courts. Thus, I would conclude that as to joint ventures *not* involving explicit price fixing or division of the market between competitors, there is no present doctrinal basis for significant Sherman Act enforcement.

This still leaves for consideration joint ventures involving price fixing or market division on the supply side of the parents' operations. It might be argued that a joint venture between competitors in the acquisition of an input (i.e. raw material, productive resource) is as much a fixing of prices, and where the supply is allocated, division of the market between competitors, as a joint venture on the output side, involving selling and distribution. In rejoinder it could be asserted that the economic effects differ significantly. A joint venture fixing prices or dividing the market for the output of competitors will generally *raise* prices, while a joint venture restraining competition for inputs, e.g. natural re-

¹⁹ See *United States v. Pan American Airlines (Panagra)*, 193 F. Supp. 18 (S.D.N.Y. 1961), *rev'd on other grounds*, 371 U.S. 296 (1963).

sources, may be thought to have the effect of *lowering* prices. The difficulty with this rejoinder is that the Supreme Court has declared with no uncertain force that a combination designed to stabilize or even to lower price is no more to be tolerated than one designed to elevate price, for both interfere with the operation of a free competitive market;²⁰ moreover, there is specific authority holding joint buying groups to be per se violations of the Sherman Act.²¹

There is some authority, nevertheless, for treating joint ventures differently, where they involve smaller firms seeking methods of competing more effectively with market leaders. In *United States v. Topco Associates Inc.*²² the Supreme Court, in striking down a per se restriction on the marketing side of defendants' operations, in effect sanctioned continuance of the joint purchasing agency of the defendant independent grocers. Clearly such joint purchasing increased the buying power of the defendants, operated to reduce purchase prices and therefore could have been described as a price fixing agreement. It was permitted because it did no more than allow smaller competitors to match the ability already possessed by the larger chains to engage in mass purchasing.

Where the parents of the joint venture have large market shares, the status of joint ventures on inputs is more questionable. Of significance may be the decision of the court of appeals in the *Penn Water* case.²³ There two Pennsylvania electric utilities formed a joint subsidiary, prophetically called Safe Harbor, to generate and sell to them electric

²⁰ See *Albrecht v. Herald Co.*, 390 U.S. 145 (1968); *Kiefer Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211 (1951); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

²¹ *National Macaroni Manufacturers Assn. v. FTC*, 345 F.2d 421 (9th Cir. 1965); see generally, Davidow, *Antitrust, Foreign Policy, and International Buying Cooperation*, 84 YALE L. J. 268, 270-274 (1974).

²² 405 U.S. 596 (1972).

²³ *Consolidated Gas v. Pennsylvania W. & P. Co.*, 194 F.2d 89 (4th Cir. 1952).

power. By explicit agreement Safe Harbor's sales of electric power were from the outset to be confined to the two parents. Holding that the parents had in other connections entered into unlawful agreements, the court declared the agreement restricting Safe Harbor's freedom to supply power to outsiders to be "an integral part of an illegal plan." Had the court said no more, the decision would be unremarkable, but the court then added:

In addition, as the District Judge found, the restraints contained in the Safe Harbor contract itself are sufficient to invalidate it. It must be borne in mind that Safe Harbor is so located as to furnish power to customers in Pennsylvania and elsewhere, and that in fact its product is delivered over the lines of Pennsylvania Water [one of the parents] to various utilities in Pennsylvania, Maryland and the District of Columbia; and were it not for the three party contract, Safe Harbor would be a *potential competitor* in this field. (Emphasis in original.)²⁴

Although the *Penn Water* court does not suggest that the joint enterprise was inherently unlawful, the decision clearly indicates the restrictions on the future independence of a joint venture involving a productive or other input resource, where the parents have large market shares, would at the least be subject to rigid scrutiny.²⁵

Vertical Joint Ventures

A vertical joint venture involves the entry of two or more companies by means of a joint enterprise into a new field, but one which is vertically connected with the present operations of the parents in that it is either a seller to or buyer

²⁴ *Id.* at 93.

²⁵ The sharp distinction that *Topco* and *Penn Water* indicate in the treatment of input joint ventures, depending on the market share of the parents is symmetrical with the general antitrust law on buying groups. See Davidow, *supra* note 21.

from them. The line between the vertical and horizontal classification can easily become blurred since a joint venture involving one process in the production cycle of the parents has a vertical relation to the other processes. Thus, in a joint venture between integrated firms, involving some stage of their operations, there may be both vertical and horizontal effects. In this paper I have treated such joint ventures as horizontal, as the horizontal effects seem of predominant significance. However, analysis of vertical implications may also be appropriate where there are significant nonintegrated firms competing at one or more stages (see discussion of *Paramount, infra*). Where, on the other hand, a joint venture involves the entry of the parents into a new stage of production, the joint venture is purely vertical and the analysis should proceed entirely along vertical lines.

The competitive problem in a vertical joint venture has at least four dimensions. First, having entered the new field by joint enterprise, it is highly unlikely the parents would also enter individually. If the alternative to the joint venture is two new market entrants, then the single entry by the joint venture has foreclosed a more competitive alternative. Second, if the joint venture provides a vital input to the parents, not otherwise available, competitors of the parent to whom this input is denied will be injured—this raises the problem of the so-called “bottleneck joint venture.” Third, competitive injury at the joint venture level could occur when the joint venture is a supplier to the parents through vertical foreclosure of the joint venture’s competitors (but this would also occur if each parent individually entered the supply market).²⁶ Fourth, if the joint venture

²⁶ This might not seem correct on first examination because unlike simple vertical integration where both affiliates are under common ownership, in vertical integration by joint venture the parent has *less* interest in the joint venture’s profits than in its own; on the other hand the parent receives a share of the joint venture’s profits from sales to the other parent. The two effects probably roughly cancel, resulting in a profit calculus similar to that under simple vertical integration.

is on the input or "upstream" side of the parents' operations and if a large part of the joint venture's output is sold to the parents, the risk of collusion between the parents may be increased. This is because efficient production planning at the joint venture level depends upon knowledge of the future production plans of the parents, and there is no feasible way for the joint venture to know this without each of the parents also knowing it.²⁷

On the other hand, a vertical joint venture can be a vehicle for promoting competition. Individual entry by the parents may *not* be feasible, and the alternative to the joint venture may thus be no new entry at all. This may be a particularly grievous loss where the joint venture market is highly concentrated and the parents' market relatively less so (thus limiting the risk of collusion between parents). If in the absence of the joint venture no firm would undertake the task, an important function will go unperformed.

Vertical joint ventures are of two basic types, (1) bottleneck joint ventures, and (2) other vertical joint ventures.

BOTTLENECK JOINT VENTURES

The bottleneck joint venture arises essentially from the circumstance that a particular stage of operations in an industry may constitute a natural monopoly. That is to say, costs per unit at the monopoly stage are declining over the whole range of output, so that it is highly inefficient, if not impossible, for more than one firm to exist. In such case the courts have permitted firms at the competitive stages of the industry to enter the natural monopoly stage through joint

Whether or not the foreclosure effect of vertical integration is a real effect is a different question; it suffices for this analysis that it is legally recognized. See *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

²⁷ I am indebted for this point to James Gillespie. Collusive risks are further increased if transfer prices between joint venture and parents are not at market price, for then output and consumption controls will be necessary to maintain equality of benefits. See M. ADELMAN, *THE WORLD PETROLEUM MARKET* at 82-89 (1972).

venture, but have required that all firms be given fair and nondiscriminatory access to the joint venture output.²⁸

Terminal Railroad is the classic case since the single terminal facility owned by the several defendant railroads was literally a bottleneck facility through which all railroads seeking to enter the St. Louis area had to pass. The Supreme Court did not condemn the joint ownership and operation of the terminal, much less the economies it made possible, but required that all railroads be given access to the single facility on nondiscriminatory terms. To the same effect is *Associated Press*, a joint venture between newspapers, where again the court did not condemn the joint venture, but struck down discriminatory by-laws which made it more difficult for competitors of member newspapers to obtain Associated Press services than noncompetitors. In each of these decisions the courts took a regulatory approach: they permitted continuation of a joint venture which achieved a beneficial result possible only through joint activity, but required regulation to avoid injury or competitive disadvantage to other firms in the industry.

OTHER VERTICAL JOINT VENTURES

The status of other vertical joint ventures under the Sherman Act is undeveloped and the precedents sparse. Nevertheless, I would suggest that the predictive factors previously outlined with respect to horizontal joint ventures may be useful as a framework for analysis. It will be recalled that these were (1) the presence of inherent or collateral per se restraints in marketing operation, (2) the market share held by the parents and the joint venture, and (3) the purpose of the joint venture.

The most useful precedent is *United States v. Paramount Pictures*.²⁹ There the major producer-distributors of motion

²⁸ See *United States v. Terminal R. R. Assn.*, 224 U.S. 383 (1912); *Associated Press v. United States*, 326 U.S. 1 (1944).

²⁹ 334 U.S. 131 (1948).

picture films, also having a dominant share of first run exhibition, held a substantial number of theatres in joint ownership both among themselves and with nonintegrated exhibitors. Such joint ownership was a relatively small part of a much larger restraint of trade, replete with per se violations. Nevertheless, the Court did not simply condemn joint ownership on the ground that it was part of the larger conspiracy, though that was mentioned.

Instead, the Supreme Court, and the district court as well, closely analyzed the vertical effects of the joint ventures between the defendants, and found them objectionable in two regards: (1) they eliminated potential competition between the parents, for in the absence of joint ownership, "the other joint owner would be in a position to operate independently";³⁰ and (2) the joint ventures tended to disadvantage independent theatres due to the "natural gravitation of films . . . to the theatres in whose earnings the distributors have an interest."³¹ Clearly, the joint ventures between defendants were thought to pose important competitive risks, and dissolution was required. In addition, even joint ventures between a defendant and a nondefendant were dissolved if there was any loss of actual or potential competition.³²

A contrary precedent is the 1960 district court *Screen Gems* decision.³³ There a joint venture between two motion picture producers for the joint distribution of their films to the television market was upheld despite the presence of price fixing. The joint venture was analyzed as vertical because one of the parents had no film distribution facility and indeed, in the court's view, even in the absence of the joint venture would not itself have entered distribution.

³⁰ 344 U.S. at 150. See also 70 F. Supp. 53, 67 (S.D.N.Y. 1947).

³¹ 344 U.S. at 151.

³² 334 U.S. at 152-153.

³³ *United States v. Columbia Pictures*, 189 F. Supp. 153 (S.D. N.Y. 1960).

The result in *Screen Gems* is to be explained in part on the basis of the small share of the market occupied by the parents, emphasized by the court, and in part on the basis of defective analysis. In applying the rule of reason the court failed to see the inevitable price fixing that was involved in a joint selling agency, much less one which included specific price formulation provisions. Moreover, it was correct only in the most limited sense to assert, as did the court, that in the absence of the joint venture the nonintegrated parent would not have entered into distribution. While the company might not have undertaken distribution itself, with a film library of immense television value it would have found another route to the market; and less restrictive distribution outlets existed than joint venture with a principal competitor. Finally, I am not alone in criticizing the opinion.³⁴

Conglomerate Joint Ventures

There appear to be no cases under the Sherman Act where the relation between the parents and joint venture was purely 'conglomerate, that is the parents and the joint venture neither produced the same product nor were in a buyer-seller relation. Although in a few decisions the relation was conglomerate with respect to one of the parents,³⁵ there has not been any significant identification of anticompetitive effects with respect to conglomerate joint ventures under the Sherman Act. Instead where one of the parents has been in a conglomerate relationship to the joint venture, analysis has focused on the relation of the joint venture to the nonconglomerate parent. To the extent there is antitrust constraint on the conglomerate joint venture, it arises under the Clayton

³⁴ See Pitofsky, *supra* note 3 at 1046-48; but see Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L. J. 373, 461-464 (1966).

³⁵ See *Panagra*, 193 F. Supp. 18 (S.D.N.Y. 1961); *Cellophane*, 118 F. Supp. 41 (D. Del. 1953); *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436 (1940).

Act (discussed below) and the yet to be developed thrust of Section 5 of the FTC Act.

JOINT VENTURES UNDER THE CLAYTON ACT

The formation of a joint venture ordinarily involves an acquisition of stock or assets which brings the transaction within the jurisdiction of Section 7 of the Clayton Act. Since the standard of illegality under the Clayton Act is broader than that under the Sherman Act, one might have expected a significant increase in the antitrust constraints on joint ventures. In fact, there has been no such development in the case law. The reason is not difficult to detect.

The key to the invigoration of the antimerger law in the 1960's was the development by the Supreme Court in *United States v. Philadelphia National Bank*³⁶ and subsequent decisions of simplified, operational rules for merger illegality. These rules made it possible to resolve the legality of a merger in a trial of limited length and complexity; and even more importantly to make some reasonable advance assessment of the antitrust hazard. This development culminated in the Department of Justice's *Merger Guidelines*, which clearly outlined the major areas of antitrust risk.

Section 7 enforcement against joint ventures has languished by comparison because there has been no similar development in that field. Instead, the Supreme Court opted in *United States v. Penn-Olin Chemical Co.*³⁷ for what amounted to a rule of reason approach. As already suggested, this is a formula which can lead only to ineffective enforcement of the antitrust laws. Not surprisingly, therefore, I have discovered only a single reported decision on joint ventures under the Clayton Act in the 12 years following *Penn-Olin*, the *Northern Natural*³⁸ case (discussed below).

³⁶ 374 U.S. 321 (1963).

³⁷ *United States v. Penn-Olin Chemical Co.*, 378 U.S. 158 (1964).

³⁸ *Northern Natural Gas Co. v. FPC*, 399 F.2d 953 (D.C. Cir. 1968).

Within this framework, and resting on the unavoidably narrow foundation of only two direct precedents,³⁹ what can be said about the Clayton Act standards for joint ventures? To begin with three general observations can be made. First, any joint venture which inherently violates the Sherman Act, or in which the collateral violation is so egregious as to require dissolution of the joint venture, would also be held unlawful under the lesser standard of the Clayton Act. But this is to say very little, for the double violation does not add to the force of existing law. Second, the Clayton Act could be used to extend the reach of the Sherman Act by attacking at a more incipient stage, cartel behavior and vertical foreclosure arising from joint ventures. In fact, there has been little development in this direction, despite mention of the point in *Penn-Olin* and inclusion as a decisional factor in *Northern Natural*.

Third, the focus of analysis has centered instead on potential competition foreclosed by the joint venture, an issue posed most vividly by the conglomerate joint venture. This has shifted the spotlight of inquiry away from the competitive implications of the actual joint venture to a consideration of an essentially hypothetical alternative, i.e. whether in the absence of the joint venture, a more competitive result might have been obtained. More specifically, *Penn-Olin* required courts to ascertain whether the parents were themselves potential market entrants, or perceived as such by firms in the market. The trouble with this development is that it has introduced an impossible and therefore defeating complexity.

Preliminary to my discussion of the case law let me attempt, as previously, to set forth a series of predictive fac-

³⁹ The *Screen Gems* decision, 189 F. Supp. 153 (S.D.N.Y. 1960), also applied Section 7 to a joint venture. But this 1960 district court decision was issued prior to the line of Supreme Court decisions developing the meaning of the amended Clayton Act and is not a reliable guide.

tors, necessarily tentative, for assessing possible Clayton Act illegality:

1. High concentration in the joint venture market.
2. Possession by the parent companies of a large market share, in their own market and substantial size in relation to firms in the joint venture market.
3. Probability that in the absence of the joint venture the parents would either enter the market in the near future or exercise a procompetitive influence on the market as recognized potential entrants.
4. Absence of other, equally potent entrants into the joint venture market.
5. Possible "spill-over" collusion between the parents.

These factors can be grouped into three basic categories: (1) the structural characteristics of the market, (2) the proximity between the parents and the joint venture market, and (3) spill-over collusion between the parents.

Structural Characteristics of Market

The development of Section 7 as applied to joint ventures has been centered on preserving the forces of new entry and potential competition affecting the joint venture market. Unless that market is concentrated, there is apt to be little need to preserve such forces, since the presence of numerous competitors within the market will generally provide all the competition desired. In fact, in both *Penn-Olin* and *Northern Natural* the joint venture market was highly concentrated, a near duopoly in one case and a monopoly in the other.

Even when the joint venture market is highly concentrated, the loss of a particular new entrant is apt to make a difference only if the entrant is likely to be a potent addition to the market, or alternatively is apt to be so viewed by firms in the market. Unless the entrant has substantial size relative to firms in the joint venture market, this ap-

pears unlikely (although not impossible, since a smaller firm could possess a unique resource or technological advantage). In any event substantial parent size was present in each of the two previous cases.

*Proximity Between the Parent
and Joint Venture Markets*

The seriousness of any loss of potential competition resulting from a joint venture varies according to the proximity between the parents and the market of the joint venture. Thus, the most serious loss occurs when the parents are already in the joint venture market and the least serious when they are both outside the market and unlikely to enter. The degree of proximity can be broken down into three rough categories: (a) both parents already in the joint venture market, (b) one parent in and the other out, and (c) both parents outside the joint venture market. Where both parents are already in the market, the joint venture is of course horizontal. Perhaps because this is the area of greatest Sherman Act coverage there are no decided cases under the Clayton Act. The cases have arisen under the two following categories.

ONE PARENT IN—ONE PARENT OUT
OF JOINT VENTURE MARKET

Where one parent is in the joint venture market and the other is out, the relation of the joint venture to the parents is mixed, partly horizontal and partly either vertical or conglomerate. This was the situation in *Northern Natural Gas Co. v. FPC*.⁴⁰ There, a joint venture had been formed between two large gas transmission companies to build a new pipeline into the service area of one of the parents—which then enjoyed a monopoly position. Thus the joint venture was horizontal as to one parent, and, as it turned out, vertical as to the other. Not only that, but the vertically related

⁴⁰ 399 F.2d 953 (D.C. Cir. 1968).

parent, Trans-Canada Pipeline, was a recognized and highly likely potential entrant into the market. The joint venture, therefore, would have the effect of preventing the entry of an independent competitor into a monopoly market; and there were also problems of vertical foreclosure of suppliers competing with the parents for the patronage of the joint venture. Not surprisingly, the court of appeals found the joint venture anticompetitive and remanded the case to the administrative agency for further consideration.

The merger decision in *United States v. El Paso Natural Gas Co.*⁴¹ represents a basically similar situation. The single supplier of out of state natural gas to the California market acquired another supplier on the eve of its threatened entry into the market. The Supreme Court held the acquisition in violation of the Clayton Act. To be sure this was a merger, but if instead of merging, the two companies had formed a joint venture to effect entry into the California market, the case would have been parallel to *Northern Natural*. That the result would have been the same is suggested by the Supreme Court's explicit reference in *Penn-Olin* to the relevance of *El Paso* to joint ventures:

The rule of *United States v. El Paso Natural Gas Co.* . . . where a corporation sought to protect its market by acquiring a potential competitor, would, of course, apply to a joint venture where the same intent was present in the organization of the new corporation.⁴²

Thus, the case law development seems sufficient in the one parent in the market and the other parent out situation to assert that where (1) the in-the-market parent has a monopoly or dominant market position, (2) the other parent is a substantial, clearly recognized potential entrant, and (3) there are no other, or very few other potential entrants,

⁴¹ 376 U.S. 651 (1964).

⁴² 378 U.S. at 170. The "intent" in *El Paso* was simply that which appeared from the face of the transactions.

a joint venture between them to enter the market will very probably be held unlawful under the Clayton Act.

BOTH PARENTS OUT OF JOINT VENTURE MARKET

Where neither of the parents is in the joint venture market, the antitrust problem is more difficult. It requires a balancing of the certain benefits of new entry by joint venture against the no more than probable benefits of seemingly more competitive alternatives.⁴³ This was the problem with which the Court in *Penn-Olin* wrestled. There the joint venture would have introduced new competition into a near duopoly market. On the other hand both parents were reasonably proximate to the market. Indeed, one produced the very same product in another geographic area, even making some shipments into the joint venture market, while the other produced vertically related and complementary products. Moreover, both parents had previously contemplated individual entry.

That a case as factually strong as this should be treated as doubtful reveals the limited reach of the Clayton Act as applied to vertical and conglomerate joint ventures. The Court noted that to establish its case the government must prove that in the absence of the joint venture either (1) entry by both parents was probable, or (2) entry by one parent was probable while the other remained a recognized potential entrant exerting a procompetitive effect on the market. As interpreted in *Penn-Olin* and subsequent merger cases, the attempt to prove what would have happened on an essentially hypothetical state of the facts, including not merely the acts, but the perceptions of firms as to market entry poses an unmanageable issue in a courtroom. But this is not the end of the difficulty in a joint venture case, for even when proved, the presence of potential competition then simply opens the door to a rule of reason inquiry.

⁴³ *E.g.*, entry by each of the parents, or entry by one and the exertion of an "edge effect" by the other.

For these reasons I would conclude that when both parents are outside the joint venture market, proof of Clayton Act illegality on a theory of injury to potential competition is unlikely and, in any event, usually impossible to predict. It is scarcely surprising that the law of Section 7 as applied to joint ventures under this theory is undeveloped.

Possible Spill-Over Collusion Between the Parents

In an often quoted dictum in *Minnesota Mining*, a Sherman Act joint venture case, the court suggested that the "intimate association" of the parents, in the operation of the joint venture, might "inevitably reduce their zeal for competition *inter sese*." ⁴⁴ In addition, the notion that the continued association of parents in a joint venture increases risk of collusion appears as a factor in the granting of the divestiture remedy in cases where the joint venture has been utilized as a collusive instrument to violate the Sherman Act. ⁴⁵ Risk of collusive spill-over has not, however, in and of itself become an independent basis for determination of Sherman Act liability despite *Minnesota Mining*. The language in that decision was no more than an aside in a case replete with more direct antitrust violation by parents which jointly dominated the United States market. Moreover, in retrospect the quoted language of the court, phrased in terms of competitive risk—except as it may have influenced the remedy—sounded less in the Sherman Act than in the Clayton Act, which was not involved in the case but which is the statute directed against incipient antitrust risks.

Turning to the two joint venture decisions under the Clayton Act, *Penn-Olin* and *Northern Natural*, we find references in each to the increased risk of cooperative action between the parents and indeed between the parents and the joint venture. In *Penn-Olin* the reference is minimal; the Court

⁴⁴ *United States v. Minnesota Mining and Mfg. Co.*, 92 F. Supp. 947, 963 (D. Mass. 1950).

⁴⁵ See *United States v. Paramount Pictures*, 334 U.S. 131 (1948); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 600 (1951).

merely noted that the formation of a joint venture would foreclose competition as between the parents and the joint venture, since it is to be expected that the operations of the joint venture "will be frozen to those lines of commerce which will not bring it into competition with the parents," and, under a similar analysis, the parents themselves "will be foreclosed from the joint venture's market."⁴⁶ The Court also spoke of the substitution for "two or more corporations previously acting independently and usually competitively" of "a triumvirate of associated corporations." But no operational principles flow from these generalities.

In *Northern Natural*, however, the risk of future collusive action by the parents for the first time appears as a factor in a joint venture decision under the Clayton Act. As will be recalled, the joint venture was between the present monopoly firm in the market and one of a very few potential entrants. After discussing the anticompetitive effects likely to result from the joint venture itself, the court turned to two other "undesirable effects," both involving possible collusion between the parents.

The first such undesirable effect resulted from the agreement between the parents pursuant to which they withdrew competing applications before the Federal Power Commission and substituted their joint proposal to serve the market by joint venture. While the court was critical of the agreement, referring to the danger of allowing potential applicants to agree on how a market should be divided, the thrust of its criticism was directed at the Commission, which it suggested should simply have not permitted withdrawal of the competing applications.

The court then turned to "a second undesirable aspect of the joint venture." The very existence of the joint venture, the court indicated, "increases the risk of joint action between the parents in future endeavors."⁴⁷ Quoting a secondary

⁴⁶ 378 U.S. at 169.

⁴⁷ 399 F.2d at 972.

source,⁴⁸ the court spoke of the "dangerous proximity" a joint venture may create between the parents, and then described the specific problem in the case:

There is certainly the opportunity for such joint action from the parents in the instant case since here the officers of the joint venture are not only named by the parent companies but also serve as officers of those companies. There are many forms which this joint action may take. One form has already made its appearance: the threatened joint boycott of [two competitors] if their proposals had been certified. A second possibility is reciprocal dealing—that is, American Natural [one parent] may continue to buy from Trans-Canada [the other parent] only if Trans-Canada promises not to sell to any competitors of American Natural. . . . Another possible form of joint conduct is that [the two parents] could plan cooperative expansion programs which would divide future markets. Thus it seems that numerous undesirable joint anticompetitive actions may spring from this joint venture relationship.⁴⁹

The court not only relies on a general propensity for collusive action between the parents, but also refers to three specific forms of parent collusion, boycotts, reciprocal dealing, and market division. These are more than mere risks in the air: the boycott has already threatened, and the court had suggested earlier that the withdrawal by the parents of competing applications before the FPC was suggestive of market division.

Northern Natural is a single decision of the court of appeals, and this makes it difficult to assess the extent to which it may have advanced the law. Perhaps a more useful inquiry is whether operative principles can be drawn from the decision. To the following extent I think they can. First, the

⁴⁸ See Brodley, *supra* note 3, at 333-334.

⁴⁹ 399 F.2d at 972-973.

stronger and more direct the existing competitive relationship between the parents, the greater the anticompetitive risk. Second, if there is evidence of parent collusion relating to the joint venture's line of business, either prior to the formation of the joint venture or thereafter, the anticompetitive risk increases. Third, the specific management and operating arrangement governing the joint venture can increase or decrease the risk of collaborative action between the parents. Fourth, the greater the economic incentives for collusive action, the greater the anticompetitive risk. Together these principles, although leaving much open, may represent a first tentative step toward a meaningful approach to the problem of possible spill-over collusion between the parents.

IMPORTANT ISSUES NOT COVERED IN CASE LAW DEVELOPMENT

In addition to the issues which have been discussed as operative factors in the decisions, there appear to be other significant elements, which are rarely if ever mentioned, but which appear of such obvious relevance that their future inclusion seems a distinct possibility. The question occurs whether inclusion of additional factors would work at cross-purposes to the possibility of clearer and more effective enforcement rules for joint ventures. The answer depends on the simplicity or complexity of the underlying rules. It is possible to include several factors in a legal rule without destroying its operational character, as the *Merger Guidelines* demonstrate. The most significant additional issues appear to be the following:

1. *Total Pattern of Joint Venture Activity by Parents*

The investigation of a particular joint venture may not uncover the full network of joint venture interconnection existing within an industry. Thus, an investigation of a particular joint venture in iron ore between two steel companies would not suggest the elaborate network of overlapping joint ventures that an economic study found actually to ex-

ist.⁵⁰ This is relevant to a legal proceeding concerned with the legality of a particular joint venture since the full anti-competitive effects can be fully appreciated only in the context of the entire structure of joint venture activities between the parents, as well as between them and others in the industry. An illustration of this approach can be found in the *Paramount* decision, *supra*, which was one of the rare cases to examine the pattern of joint ventures for an entire industry. The need for looking at the whole joint venture network seems especially strong in a Clayton Act proceeding, where the range of the statute is broader, but the focus of proof is otherwise apt to center narrowly on the particular joint venture acquisition being scrutinized.

2. *The Relation of the Joint Venture to Other Structural Characteristics of the Parents*

The competitive implications of a joint venture should be viewed also in the context of other structural characteristics of the parents, such as vertical integration, major contractual arrangements and exclusive dealing. The existence of the joint venture changes the incentives and relationships of the firms involved, but one cannot understand how those incentives and relationships operate without knowing the full structural pattern of the parents. An example of the interrelation of joint ventures with other structural characteristics is provided in Professor Adelman's study of the petroleum industry.⁵¹

3. *The Actual Operation and Organization of the Joint Venture*

With public shareholders usually absent, a joint venture can be organized and run with varying degrees of parental supervision and coordination. What in fact is the organizational plan and method of operations can have important

⁵⁰ See D. Fusfield, *Joint Ventures in the Iron and Steel Industry*, 48 AM. ECON. REV. (Papers & Proceedings) 578 (1958).

⁵¹ See ADELMAN, *supra* note 27, at 82-89.

competitive implications. At the same time it must be recognized that an organization which appears to minimize competitive risk is subject to change at any time if the parents agree.

4. The Need for More Information on Joint Ventures

While joint venture acquisitions involving assets or sales of \$10 million or more by companies having combined assets or sales of \$250 million or more must be reported to the FTC,⁵² so far as I know there is no general available inventory of existing joint ventures. SEC reporting requirements are far from comprehensive.⁵³ Since joint ventures are typically small and privately held, the existence as well as the activities of many may escape notice. In view of their competitive sensitivity, more information would appear highly desirable. It should at the very least be possible to examine the full universe of joint ventures in each concentrated industry.

5. Duration of the Joint Venture

A joint venture may be established for a particular purpose, on balance desirable although carrying competitive risk. Events may change; the justifying purpose may disappear; the anticompetitive balance may shift. Joint ventures between major competitors in particular should be periodically reviewed to determine whether the original justifying need continues, and whether other economic and structural developments have increased the competitive risk. Legitimacy of a joint venture at its outset should not be deemed a perpetual charter.

⁵² 1 CCH Trade Reg. Rep. ¶4540.

⁵³ See 1 CCH Fed. Sec. L. Rep. ¶¶23,033, 31,103.