

# JOINT VENTURES

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### A practical guide to antitrust analysis and structuring of joint ventures

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Joint ventures, a traditional and widely used form of business relationship, have recently been the subject of particular scrutiny by the US antitrust enforcement agencies. The Antitrust Division of the United States Department of Justice has been particularly active in this regard. Not long before he announced his resignation in October 2002, Assistant Attorney General Charles James, the Division's head, confirmed that the Division has numerous ongoing joint venture investigations and has made them a high enforcement priority. Suggesting that parties that might have merged in the past are now turning to joint ventures instead, James expressed particular interest in joint ventures among competitors that do not appear to increase consumer or other customer welfare.

Several joint venture investigations pending at the Division involve ventures among competitors to distribute goods or services over the Internet. While that form of distribution is relatively new, the antitrust issues the ventures present are not. Thus, attention to potential antitrust risks remains essential throughout the creation and operation of all joint ventures.

The term 'joint venture' has long been used to describe a variety of cooperative business arrangements, including strategic alliances, teaming agreements, subcontracts, and many other relationships among two or more independent business entities. However denominated, joint ventures may serve a variety of legitimate business purposes. For example, they may permit participants to offer a product or service that they could not or would not offer alone; to create new productive or service facilities that otherwise would not exist; and to achieve economies and efficiencies of operation without eliminating whatever competition would otherwise exist.

Some joint ventures also have the potential to restrict competition among participants either inside or outside their venture or to restrict competition between non-participants and participants or their venture. For this reason, joint ventures have long been the subject of antitrust review by both federal and state antitrust enforcement agencies and in private antitrust litigation.

The standards for antitrust analysis of joint ventures are reasonably well accepted and known. Those standards are summarised in the Antitrust Guidelines for Collaboration among Competitors issued by the Division and the Federal Trade Commission and in other sources.

Participants who consider these standards carefully from the outset can almost always structure their venture to achieve their legitimate business objectives in a manner that is wholly consistent with the antitrust laws. This process inevitably involves a number of decisions and trade-offs that balance business risk or uncertainty with antitrust risk under both present and unknown future circumstances.

It is often possible to approach many of these individual decisions in a manner that would eliminate virtually any antitrust risks associated with them. However, there is no absolute 'right' or 'wrong' approach to most such decisions from an antitrust perspective for at least three reasons. First, the outcome of the antitrust

analysis of any particular venture usually depends on the combined impact, if any, of all the decisions (not a single decision) on competition among participants, between them and their venture, and between non-participants and the venture or its participants. Second, if the venture is challenged under the antitrust laws, its competitive impact will be evaluated as of the time of the challenge, not just at the time the venture is formed. Finally, choosing the most conservative or 'risk-free' course from an antitrust perspective may prevent full realisation of the venture's legitimate objectives and be unnecessary from an antitrust perspective.

The challenge for prospective venture participants and their counsel under these circumstances is to structure the proposed venture in a manner that is sufficiently flexible to adapt to both present and unknown future competitive circumstances, while avoiding ambiguities that may raise potential antitrust concerns. There is no magic formula for doing so, even as to any particular venture. There are, however, a number of questions whose answers will contribute substantially to systematic and effective analysis and structuring of the proposed venture and to avoiding unnecessary antitrust risks.

#### **Guidelines for antitrust analysis**

The list of questions to be asked about any particular proposed venture must obviously be tailored to its goals and to the context in which that particular venture would operate. However, the following questions should always be included.

#### ***Do the venture participants compete with each other?***

The fact that participants are actual or potential competitors does not automatically mean that the venture is contrary to the antitrust laws, but it does typically suggest a need for more caution in structuring the venture. Moreover, the fact that participants do not compete and are not expected to do so in the future does not necessarily protect the venture from potential antitrust concerns. Such concerns could conceivably arise, for example, if the venture gives one or more participants the ability to deprive their competitors of some asset or resource they need to compete.

#### ***Exactly what will the venture do, and how will it do it?***

These questions will help determine whether the venture raises the types of issues (eg horizontal price fixing or customer or territorial allocation) that are often subject to the per se rule and, at a minimum, require special antitrust sensitivity. They will also assist in determining whether various provisions or restrictions in the venture agreements are truly ancillary to – and reasonably necessary to achieve – the venture's legitimate purposes. Although the questions may seem obvious, experience suggests that prospective participants in a venture often proceed with only a general sense of wanting to 'work together' in some broadly defined area and little sense of the specifics. Such relatively unfocused objectives are often the source of antitrust concern. For example, they may be ambiguously broad and

subject to a misinterpretation that would suggest antitrust problems; they might also be so general that they make it difficult for the parties to seek or to obtain effective guidance from antitrust counsel on how to avoid antitrust risks in negotiating and structuring the venture. Thus, prospective participants should focus on specifics with antitrust counsel from the earliest stage and develop a business plan or comparable documents that will provide a basis for detailed antitrust guidance and planning on an ongoing basis.

***What benefits will the venture provide to participants, consumers (or other customers), and other third parties?***

Participants obviously and appropriately enter joint ventures to benefit themselves. Assuming those benefits are not per se unlawful, they help to justify the venture, to define what other requirements of the venture are reasonably ancillary and necessary to its legitimate purposes, and to offset any restrictions the venture might impose upon competition. The benefits the venture offers to consumers, other customers, or other third parties affected by the venture are usually even more significant in this regard. Participants and their counsel should always keep those benefits in mind in structuring the venture and in their communications about it.

***What legal form will the venture take?***

Joint ventures may be merely contractual or may involve formation of one or more legal entities (eg a corporation, partnership, LLC, etc). The selection of the venture's legal form could obviously have business, tax, and similar ramifications. It may also have antitrust significance in at least two respects. First, it may impact the decision whether the venture is subject to Hart-Scott-Rodino or similar merger notification requirements. Second, it may determine whether the participants have sufficiently integrated their operations from a financial or other perspective to obviate antitrust concerns that the venture might otherwise raise. Stated differently, the selection of a form for the venture may help determine whether antitrust analysis of its activities proceeds primarily under a Clayton Act Section 7 merger analysis or a Sherman Act Section 1 analysis of agreements in restraint of trade. While these antitrust considerations are significant, business considerations should normally determine the legal form the venture will take, with antitrust considerations influencing how that form is structured and shaped.

***In what business sectors and activities and in what geographic areas will the venture and its participants be involved, either collectively or individually?***

Ultimately, analysis of a venture's competitive effects, if any, would be made in the context of relevant product and geographic markets. However, it is often impractical or impossible during the planning stage of a venture to determine precisely what the relevant markets might be at that time, much less in the future. The more practical and prudent approach is to determine what industries and specific business activities might potentially be affected by a venture and where those effects might occur. Using this information as a proxy for potential relevant markets, one can then seek to structure the venture to avoid anti-competitive effects in each such market.

***What other firms compete in those activities and geographic areas, and what are their respective shares of sales, purchases, production, or other measures of competitive significance?***

Market 'share' does not necessarily equate to market 'power', the focus of antitrust analysis. For example, some ventures may be competitively neutral or pro-competitive (and accordingly raise no antitrust concerns) even though they involve virtually all participants in an industry, because they involve some ministerial or other function that is not

competitively sensitive. As a general rule of thumb, however, the greater the individual and combined market shares of the venture and its participants, the greater the potential competitive effects of the venture and the greater the care needed in structuring the venture.

***Will participants deal exclusively with their venture?***

Antitrust analysis will examine both the legal requirements imposed by the venture and the economic incentives it creates in answering this question. The answer may not affect antitrust analysis significantly if the venture represents only a small share of overall activity in the businesses in which it is engaged. However, if it represents a large share of such activity, an agreement by participants to deal exclusively with their venture is more likely to have competitive effects. For example, if participants form a venture to purchase a particular product or service and agree to purchase that product or service exclusively through the venture, the possibility of competitive effects will generally increase as participants' combined share of total purchases of the product or service increases.

***Will the venture permit non-owners to participate and, if so, will it deal with owner and non-owner participants on the same terms?***

The answer to this question will probably not affect antitrust analysis if participation in the venture is not necessary in order for non-owners to compete with owners. However, if the venture offers a necessary product or service that non-owners cannot practically obtain elsewhere, or if the venture makes that product or service available to non-owners only on terms that do not let them compete effectively with owner participants and that cannot be explained by the owners' capital or other contributions to the venture, the possibility of anti-competitive effects is greater. Keep in mind, however, that the antitrust laws are ultimately concerned with effects on competition, not competitors. Thus, injury to a particular non-owner's ability to compete may not have any antitrust significance if it does not unreasonably restrict competition in the affected markets.

***What are the standards for granting, denying, or terminating the right to participate in the venture and who applies them?***

The answer to these questions again may not affect antitrust analysis significantly if participation in the venture is not necessary to the ability to compete with participants. If such participation is necessary, it will be important that standards for admitting prospective participants and for terminating existing participants be objective, clearly stated, consistent with the venture's legitimate purposes, and uniformly applied in a manner that does not permit individual participants to use the standards to promote their own individual interests contrary to the interests of the venture and other participants. It is also generally preferable to have the standards applied by persons who are independent of 'interested' participants. In some instances, these suggested precautions may be dictated by antitrust requirements. However, in many instances, they are calculated more to create a sense of fairness that will discourage potential antitrust challenges than to comply with clear antitrust requirements.

***Will the venture's principal business relationships be with participants or with third parties?***

The answer to this question will help determine who (eg the venture's competitors, its suppliers or customers, participants' competitors, or their suppliers or customers), if anyone, is likely to be affected by the venture's activities. Identification of such likely affected parties will in turn help guide numerous decisions in structuring the venture to avoid potential anticompetitive effects. For example, in the case of a joint production venture, resolution of the issue whether the output of the venture will be sold to partici-

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pants (for use or resale) or to third parties could have substantial antitrust significance in determining who will participate in or influence the venture's decisions on its sales price and on the customers to whom or the geographic areas in which it will sell. If the venture will sell at least in part to third parties who compete with participants, or who also buy from participants (who compete with their venture), it may be important in many circumstances to have the joint venture's sales negotiations and decisions made by persons other than participants.

### ***Are any restrictions on the competitive activities of the venture or its participants reasonably necessary to accomplish the venture's legitimate purposes?***

Antitrust analysis of this issue will again focus both on the legal requirements imposed by the venture and on the economic incentives it creates. The fact that the venture involves some restriction on competition does not necessarily mean that it violates the antitrust laws. For example, competitors who form a venture involving substantial investments by each of them in an activity in which none of them could engage individually and in which success is highly uncertain may be unwilling to participate if their fellow participants are also supporting a competing venture. In these circumstances, the restriction on competition may be necessary for the pro-competitive venture to exist. Conversely, the fact that a venture is pursuing legitimate objectives does not necessarily mean that every requirement it might adopt or every economic incentive it might create can be successfully defended against antitrust challenge so long as it somehow contributes to the venture's overall success. Instead, one should examine each such requirement to evaluate its competitive impact, if any, and to determine whether it is reasonably necessary to achieve the venture's legitimate objectives.

### ***Will the venture result in the exchange of competitively sensitive information among competitors?***

Ventures whose own activities have no anti-competitive effects may still raise antitrust risks if they result in the exchange of competitively sensitive information that could reduce competition among venture participants or others. For example, a venture that provides order fulfilment services to its competing participants could conceivably reduce competition among those participants if it discloses the sales prices of one participant to another. As this example suggests, it is usually possible to manage this issue successfully through 'firewalls' or other restrictions that control who has access to competitively sensitive information available to the venture.

### ***Will the venture have any other adverse 'spillover' effects on competition?***

The issue here is whether the venture will adversely affect competition outside the venture itself and is usually focused upon whether and, if so, how the venture might affect the opportunity and incentives for continued competition among participants and others.

### ***Who might complain about the venture and why?***

All of the preceding questions have been designed to determine whether a proposed venture will have anti-competitive effects that may violate the antitrust laws. Although not stated in formal antitrust terminology, they essentially track key elements of traditional antitrust analysis. This question takes a more pragmatic approach by asking who might attack a venture and what they might say. The fact that someone might attack the venture does not mean, of course, that it violates the antitrust laws. For example, businesses that feel that a venture will increase the competition they face often unjustifiably attack the venture for that reason. They do so despite the fact that such an effect is normally pro-competitive, not anti-competitive, and fully consistent with the purposes of the antitrust laws to protect competition, not competitors. Other complaints may be more legitimate, however, and this question is often the most effective way to obtain useful input from businesspersons concerning the antitrust issues a proposed venture might present.

### ***Is the proposed venture subject to notification requirements under the Hart-Scott-Rodino Act or similar foreign statutes and regulations?***

Notification pursuant to such requirements can obviously provide an early antitrust and competition law review of a proposed venture. It can also involve considerable time and expense. It is important to consider this issue during the early stages of forming the venture both to ensure compliance with all notification requirements and to avoid delaying implementation of the venture unnecessarily while any mandatory notifications are being reviewed.

### ***Other practical suggestions***

In addition to following this systematic and focused approach in analysing and structuring a proposed venture, participants and counsel should keep a number of practical considerations in mind.

First, wherever possible, seek a 'win/win' solution for all participants, the venture, and the parties with whom they deal to reduce the possibility of complaints about the venture and to undermine the credibility of those that may unavoidably arise.

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Second, consider the issues discussed above carefully and deal with them during the formation of the venture. Ignoring this advice and assuming that one can 'add the details' later may pose avoidable antitrust risks in negotiating the venture, often results in unnecessary challenges or investigations, and may increase the time and expense involved in any that do arise.

Third, remember that the antitrust implications of a venture may change over time and continue to monitor its competitive impact throughout its implementation and operation.

Fourth, when the number of potential participants is significant or there is substantial debate about the antitrust ramifications of the venture, consider getting separate antitrust counsel for the venture itself. This will help separate antitrust from business issues and will also ensure that at least one counsel has only the interests of the venture in mind and will seek to structure the venture accordingly. It can also be useful in identifying and avoiding potential antitrust issues during the life of the venture.

Fifth, be certain that prospective participants have at least general antitrust guidance from the outset of consideration of a new venture. Many unnecessary antitrust complications arise because the participants defer requests for guidance until after wholly avoidable problems have already arisen. Written antitrust compli-

ance guidelines, even if necessarily general, can identify potential antitrust pitfalls for participants in advance, enable them to know when to seek additional antitrust guidance, and provide a guide for participants' actions and statements throughout the formation and operation of the venture.

Finally, assume that a sceptical antitrust enforcement agency or private adversary will scrutinise everything the venture and participant representatives say and do, and write, speak, and act accordingly. This does not mean, of course, that one should not accurately describe what is said and done. It does mean that one should think and consult with counsel before speaking and acting in sensitive areas and that one should avoid ambiguous statements and actions that could be misconstrued or become the subject of unnecessary inquiries.

### Conclusion

The antitrust laws should not provide an impediment to legitimate joint ventures. Structuring a venture to avoid potential antitrust pitfalls requires an approach tailored to the specific goals and activities of the venture and its participants and to the competitive circumstances within which they will operate. The guidelines presented above should assist in developing such a tailored approach.

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