The Competitor Collaboration Guidelines: Old Wine in New Bottles

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There are occasions when an idea or concept is so old that it becomes new again. Such is the case with respect to the ancillary restraint doctrine in the antitrust world. Over a century ago, Judge (and later Chief Justice) William Howard Taft, articulated the antitrust principle that, when a business partnership is formed, restraints on competition among the participants were to be "encouraged" since they were only ancillary to the main end of the union, and necessary for its success.1/ This became known in antitrust circles as the "ancillary restraint doctrine." This doctrine has been embraced in the "Antitrust Guidelines For Collaborations Among Competitors" (hereinafter "Guidelines") issued in April, 2000 by the federal antitrust enforcers, the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice (DOJ). The basic principle underlying the Guidelines is that, in some circumstances, restraints that otherwise might be considered per se illegal -- such as price fixing -- are subject to the rule of reason and may not be illegal at all if they are reasonably necessary to achieve pro competitive benefits from an "efficiency-enhancing integration of economic activity." To a large extent, this is simply the ancillary restraint doctrine dressed in modern e-commerce language.

The purpose of the Guidelines is to provide guidance to the business and legal community as to when the federal antitrust enforcers will challenge the legality of a "competitor collaboration" under the antitrust laws. "Competitor collaborations" (aka joint ventures) are simply agreements among competitors short of a merger to jointly engage in a business activity such as production, marketing, or research and development. Competitor collaborations by definition involve some curtailment in competition among the participants and thus necessarily raise serious antitrust issues.

Although joint ventures and other competitor collaborations have a long history, their use as a business tool has exploded in recent years. In the first few months of 2000, there were many public announcements about the formation of business to business ("B2B") e-commerce sites among major competitors in several "old economy" industries. Such B2B collaborations included those between Ford, GM, and DaimlerChrysler in the automotive industry, Boeing, Raytheon and Lockheed in the aerospace industry, and McKesson, Cardinal and others in the healthcare field.2/ Another fertile area for competitor collaborations is foreign marketing necessitated by globalization, as such joint efforts can substantially reduce costs and achieve other efficiencies. Competitor collaborations are also a logical way to approach the development of new products or technology that will benefit consumers. Since it would be unwise and futile for antitrust law to stand in the way of such progress, a return to the ancillary restraint doctrine permits such collaborations to proceed but still challenge those that are mere disguises for hard core cartel behavior.

A. The Ancillary Restraint Doctrine

The ancillary restraint doctrine simply provides that a restraint among competitors that would otherwise be illegal may not be so where it is part of a broader business combination that may lower prices, provide better products, or otherwise benefit consumers. The doctrine actually predated the rule of per se illegality by slightly over a decade.3/ The per se rule provides that certain categories of restraints, such as horizontal price fixing or market allocation agreements among competitors, are presumed to unreasonably restrain trade without any analysis of market conditions or the business purpose of such restraints. Other restraints, such as exclusive dealing and vertical territorial or customer restraints, are deemed unreasonable only after an analysis of the market and their impact on competition.4/ During much of the first two-thirds of the Twentieth Century, the ancillary restraint doctrine was relegated to an archaic principle as the per se rule was steadily expanded to include almost any arrangement among competitors which had a negative impact on competition.5/

The ancillary restraint doctrine began its modern comeback in *Broadcast Music Inc. v. CBS*,6/ a 1979 Supreme Court decision. In *Broadcast Music*, thousands of authors and composers had joined together and granted nonexclusive rights to two joint venture type entities to offer a blanket license to all their musical compositions. Although the Second Circuit held the arrangement to be per se illegal price fixing, the Supreme Court reversed noting that the blanket license accompanied the integration of sales, monitoring, and enforcement against copyright infringements and thus was potentially beneficial to both sellers and buyers. It remanded the case for review under the rule of reason. This was followed by *NCAA v. Board of Regents*,7/ which held that restrictions imposed by a membership organization governing intercollegiate athletics should be judged under the rule of reason rather than summarily condemned by the *per se* rule. This led to a series of appellate court decisions enunciating the principle that restraints ancillary to a legitimate joint venture should be analyzed under the rule of reason rather than summarily condemned under the *per se* rule.8/

The return to the ancillary restraint doctrine has been most pronounced in the health care area. A 1982 Supreme Court decision.9/ struck down as *per se* illegal price fixing an agreement among competing doctors to adhere to a maximum fee schedule, but noted that such an agreement might be permissible under the rule of reason if the doctors had formed a partnership or otherwise pooled their capital or shared risk to achieve integrative efficiencies. Later decisions picked up on this point and permitting physicians and other medical providers to fix fees when they were part of groups that achieved "integrative efficiencies" through risk sharing or otherwise.10/ In 1994, the DOJ/FTC issued their Statements of Antitrust Enforcement Policy in Health Care which permit medical providers to jointly negotiate fees with health care payors so long as there is risk sharing or similar integration.11/ The Health Care *Guidelines* also adopted the principle that price and other restraints collateral to these integrations would be evaluated on the basis of whether the collateral restraints are reasonably necessary to achieve the efficiencies sought by the joint venture. Thus, modern antitrust jurisprudence recognizes that joint ventures among competitors can sometimes lower prices, improve products or channels of delivery, and that the success of such ventures is dependent in part on eliminating some aspects of competition among the joint venture participants. Hence the return to the ancillary restraint doctrine.

The *Guidelines* set forth the "analytical framework" by which the federal antitrust enforcers will judge joint ventures by B2B e-commerce ventures. As is usually the case with such enforcement guidelines, they begin by reiterating the principle that hardcore antitrust violations -- such as horizontal price fixing and market divisions -- unconnected to any "efficiency-enhancing integration of economic activity" -- are *per se* illegal and subject to criminal prosecution. The *Guidelines* then go on, however, to articulate some general principles, largely derived from court decisions, to guide firms considering various types of competitor collaborations. While the *Guidelines* are quite useful, much uncertainty remains and in some respects they raise more questions than they answer.

B. Types Of Collaborations To Which Guidelines Apply

The Guidelines apply to any competitor collaboration short of a merger. Such collaborations normally involve one or more business activities, such as research and development ("R&D"), production, marketing, distribution, sales or purchasing. While mergers end competition entirely between the merging parties, competitor collaborations preserve some form of competition among the participants. In the event that a business arrangement labeled as a joint venture or collaboration in fact eliminates all competition among the participants in a relevant market, the *Guidelines* state that it will be treated as a merger for purposes of antitrust analysis.12/

As noted above, for a competitor collaboration to receive favorable treatment under the *Guidelines*, it must be an "efficiency-enhancing integration of economic activity." The "efficiency-enhancing" aspect of this phrase means that it must achieve a cost savings or other benefit to consumers by expanding output, reducing prices, or enhancing quality, service or innovation. The "integration" aspect of this phrase requires that the participants make a real contribution, by contract or otherwise, of significant capital, technology, or other complimentary assets to the joint venture or other collaboration itself. Absent such efficiencies and integration, the mere coordination of decisions on prices, output, customers, and other competitively sensitive subjects will be summarily condemned under the *per se* rule.13/

C. Key Factors To Consider In Forming A Competitor Collaboration.

While the precise antitrust analysis which applies to any joint venture or other competitor collaboration will vary, the *Guidelines*, and applicable case law, identify seven (7) key inquiries that should be made by a business before embarking on a joint venture or similar competitor collaboration. They are:

1. Type of business function.
2. The market power of the participants.
3. Whether any collateral restraints would be per se illegal outside of a joint venture.
4. Whether such restraints are reasonably necessary to the collaboration.
5. Whether the collaboration facilitates collusion.
6. The degree to which the participants continue to compete.
7. How long will the collaboration last.

A more thorough explanation of each inquiry is as follows:

1. Types of business function: Most competitor collaborations fall into one of four categories -- marketing, production, purchasing, or research and development ("R&D"). The *Guidelines* state that "most" R&D agreements are pro-competitive, and typically analyzed under the rule of reason. The same is true, although to a lesser extent, of purchasing collaborations. The Guidelines likewise concede that competitor collaboration involving agreements to jointly produce a product are "often pro-competitive." The highest degree of antitrust risk lies with marketing collaborations. Such collaborations involve agreements to jointly sell, distribute or promote goods and services and thus often result in agreements on price, output, or other competitively significant variables that can result in anticompetitive harm.

2. The market power of the participants: This requires an identification of the relevant market utilizing the tests set forth in the Horizontal Merger Guidelines, followed by a determination of the market shares in that market of each of the participants. It also requires an analysis of barriers to entry, as a high market share may not be an

indicia of market power if barriers to entry are low in the market in question. The *Guidelines* do contain a "safe harbor" where the market share of the participants is 20% or less and does not involve agreements that are otherwise per se illegal. There will, however, be many cases in which collaboration involving market shares above the safe harbor threshold will be permissible depending upon the facts and circumstances. The Guidelines themselves are quick to note that they are not designed to "discourage" collaborations falling outside the safe harbors.

3. Type of Restraints: Another major factor is whether the restraints among competitors that accompany a collaboration are restraints which, outside the joint venture context, would be considered to be *per se* illegal or subject to the rule of reason. Restraints which usually result in high prices or lower output, such as price or output restrictions, are much more likely to invalidate the collaboration than other restraints which impose reasonable limits on the ability of collaborators to do business outside the collaboration. Nonetheless, the Guidelines frequently reiterate the principle that restraints that might otherwise be considered per se illegal may be judged under the rule of reason when reasonably related to, and reasonably necessary to achieve, the pro competitive benefits of the collaboration or joint venture.

4. Whether the Restraints Are Reasonably Necessary: The next area of inquiry should be whether the restraints, regardless of whether they fall into the per se or rule of reason categories, are "reasonably necessary" to achieve the business purpose and pro-competitive benefit of the proposed collaboration. The *Guidelines* take the position that such restraints may be reasonably necessary "without being essential." If, however, the business purpose and pro-competitive benefits of the collaboration can be achieved through less restrictive means, then the restrictions may not be reasonably necessary. This obviously is a fact specific inquiry which requires a careful analysis of the purpose of the collaboration and whether the collateral restraints are really necessary to achieve its objectives.

5. Facilitating Collusion: Whether the proposed collaboration will be used as a facilitating device to exchange competition sensitive information unrelated to the collaboration and thus promote collusion among the participants is a major concern of the enforcement agencies. Since the *Guidelines* by definition deal only with "competitor" collaborations, such collaborations provide an opportunity for the participants to discuss and agree on prices, output, customer or other competitively sensitive information which may be unrelated to the purpose of the collaboration entirely. It is very important that safeguards be adopted and implemented.

6. Continued Competition: This is the extent to which the collaboration prevents participants from continuing to compete against each other. The Guidelines state that collaborations accompanied by exclusivity are more likely to raise antitrust concerns. For example, where the joint venture participants in a B2B e-commerce exchange are prohibited from selling, or purchasing, their products through another exchange, this is more likely to raise antitrust concerns than where such participation is on a non-exclusive basis. While the success of the collaboration often requires some degree of exclusivity, it is wise to structure the agreements to permit the participants to conduct some business activity in the relevant market outside the collaboration, as well as continue aggressive competition with respect to business functions not covered by the collaboration.

7. Duration of The Collaboration: A collaboration of unlimited duration obviously reduces the ability and incentive of the participants to compete against each other. The *Guidelines* state, not surprisingly, that the shorter the duration, the more likely the participants are to compete against each other. The Guidelines offer no meaningful statements as to what is too long, and it will vary depending on the industry and the nature of the collaboration. As a rule of thumb, however, those in the one to three year range are likely to be upheld depending on the outcome of the analysis of the other factors set forth above. In any event, it is wise to have a "sunset" or

similar provision in most collaboration agreements.

The foregoing is not an exhaustive list of factors set forth in the *Guidelines*, but does identify those most likely to be dispositive and at least some will apply to most joint ventures. Other factors identified in the *Guidelines* include the extent to which participants have a financial interest in the collaboration (the greater the financial interest, the less likely is the participant to compete with the collaboration) and the degree of control of the collaboration's decision making process held by their participants. (The greater the degree of control over the collaborations' price output, and other competitively significant decisions, the less likely it is that the collaboration will compete independently.) In any event, as emphasized previously, the antitrust analysis applicable to any collaboration depends upon the nature of the collaboration, the industry involved, and other inquiries that can be make only on a case by case basis.

D. Safety Zones

Like prior enforcement guidelines in the merger, health care and intellectual property areas, the competitor collaboration guidelines include "safety zones" to provide potential collaborators with a degree of certainty that, in some situations, the anticompetitive effects are so unlikely to occur that the collaborations will be presumed lawful. Here, however, there are only two safety zones which themselves are subject to various qualifications and exceptions.

The first safety zone is where the participants account for no more than 20% of each relevant market which competition may be effected. This safety zone, however, does not apply to agreements that are otherwise per se illegal, or that would be challenged without a detailed market analysis such as those subject to the "quick look" rule of reason analysis.14/

The second safety zone applies only to R&D collaborations in innovation markets. An innovation market is one that consists of research and development directed to particular new or improved goods or processes. The safety zone exists where, in addition to the collaboration itself, there are three or more independently controlled research efforts that possess the specialized assets or characteristics and the incentive to engage in R&D that is either the same as, or a close substitute for, the R&D activity of the collaboration. Again, this safety zone does not apply to agreements that are otherwise per se illegal, or that otherwise would be challenged without a detailed market analysis. Thus, while two safety zones exist, they really do not provide much safety. The Guidelines are quick to note, however, that the purpose of the safety zones is to establish a rule of certainty for the business community and they do not intend to discourage competitor collaborations that fall outside the safety zones.

E. Conclusion

Subject to the various qualifications, the basic purpose of the competitor collaboration guidelines is to tolerate, if not endorse, restraints on competition among competitors where such restraints are necessary to the success of a joint venture or other collaboration which itself may result in lower prices, better product, or other benefits to consumers. In this respect, it "frees" the business community to better adapt to an economy characterized by increased globalization and rapid technological change. While such an economy cannot have been foreseen by Judge Taft when he formulated the ancillary restraint doctrine over a century ago, it does demonstrate the willingness of the enforcement agencies, and the courts, to adapt traditional antitrust principles to fit the needs of the modern world. As can be seen from the foregoing analysis, however, many aspects of the *Guidelines* are obscure and a substantial degree of uncertainty exists, and will continue to exist as to how to apply these principles to specific collaborations. Early and effective antitrust counseling is both necessary and desirable when firms contemplate joint ventures or similar competitor collaborations.

Endnotes

1/*United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898) *aff'd as modified* 175 U.S. 211 (1899).
2/See "B to B Ain't Dead Yet," Industry Standard/Yahoo News June 1, 2000.
3/*Standard Oil Co. v. United States*, 221 U.S. 1, 60-70 (1911).
4/*Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961); *Continental T.V. v. GTE Sylvania*, 433 U.S. 36 (1977).
5/See e.g., *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. Sealy*, 388 U.S. 350 (1967).
6/*Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979).
7/468 U.S. 85 (1984). It should be noted that the restraints in *NCAA* were held to be unlawful under the rule of reason.
8/See e.g., *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d. 210, 224 (D.C. Cir. 1986); *SCFC ILC, Inc. v. Visa, Inc.* v. 36 F.3d. 958 (10th Cir. 1994).
9/*Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982). 10/See, e.g., *Hassan v. Independent Practice Assocs.*, 698 F.Supp. 679, 688-90 (E.D. Mich. 1988).
11/1994 Health Care Statements, amended 1996, 4 Trade Reg. Rptr. (CCH) ¶ 13, 153.
12/It should be noted, however, that many joint ventures that are not mergers are subject to the premerger notification requirements of the Hart-Scott-Rodino Act. See 16 CFR 801.40.
13/See, e.g., *State of New York v. St. Francis Hospital*, 2000 U.S. Dist. Lexis 4655 (S.D.N.Y. 2000).
14/See, e.g., *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986).

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