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Supreme Court Decisions Reveal Possible Shift on Tying and Joint Ventures

Antitrust decisions by the U.S. Supreme Court are rare. So it was a banner week when the Court released two opinions, both decided on 8-0 votes, affecting the application of the antitrust laws to tying and joint ventures. Significantly for this conservative court, *Illinois Tool Works Inc. v. Independent Ink, Inc.* and *Texaco Inc. v. Dagher*, both appeared to go beyond the more narrow issues presented, perhaps presaging a greater acceptance of tying and a decreasing appetite for rules of *per se* illegality.

In *Independent Ink*, the Court:

- Held that market power may no longer be presumed from a patent
- Observed that tying is often procompetitive or, at worst, competitively benign
- Suggested that the *per se* rule may no longer apply to tying
- Hinted that other changes in antitrust law may be coming

The previous day, in *Dagher*, the Court:

- Rejected application of Section 1 of the Sherman Act to the pricing decisions of legitimate joint ventures
- Adopted a rather broad characterization of what constitutes a legitimate joint venture
- Gave further signals that the *per se* rule against minimum resale pricing may be next on the chopping block

The Independent Ink Decision

"This Court's strong disapproval of tying arrangements has substantially diminished."

Independent Ink presented only a narrow issue of patent and antitrust law, but the Court seized the opportunity to present a much more sympathetic view of tying than it has expressed in the past. While not disturbing precedent that tying can be anticompetitive if the plaintiff proves, among other things, that the seller has market power in the tying product, the Court recognized more emphatically than in the past that many tying arrangements are procompetitive. Although short on specifics beyond the question presented, the decision may raise the bar for all tying plaintiffs by establishing that tying arrangements are not inherently suspect.

The extent of this shift in tone can be illustrated with two short quotes. In the Court's last major decision involving tying, *Jefferson Parish*, Justice Stevens wrote in 1984 on behalf of the majority:

> It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition. . . .

In *Independent Ink*, Justice Stevens wrote on behalf of the entire Court:

> Many tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market.

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The threat of tying claims against sellers of patented products is now reduced, although antitrust challenges to tying involving patented goods can still succeed in some circumstances. The Court's generous language was all the more remarkable given the narrowness of the question actually presented by the case.

Patents No Longer Assumed to Convey Market Power

The issue in *Independent Ink* was whether, in an antitrust challenge to the tying of an unpatented product to a patented one, the plaintiff must prove that the defendant has market power in the tying product or can instead rely on a rebuttable presumption that the patent conveys market power. Because courts in the past recognized such a presumption, tying claims involving a patented good were considerably easier to prove, and considerably more expensive to defend, than tying claims involving unpatented goods. There was no principled reason for the difference. The presumption was simply a throw back to an earlier day in antitrust, when harsh and simplistic rules governed a number of business practices now reviewed in a more nuanced way, consistent with contemporary economic analysis.

When the Federal Circuit reviewed the case, it concluded that it was bound by Supreme Court precedent to continue to apply the presumption until the Supreme Court overruled its old decisions. It nevertheless sharply criticized the presumption and made clear that it hoped the Supreme Court would grant *certiorari* and reverse.

The Supreme Court willingly obliged. It unanimously overruled its prior decisions and rejected future use of any form of a presumption that a patent conveys market power. It suggested that in adopting the presumption in the first place, it had largely followed the lead of Congress and the enforcement agencies. Their subsequent rejection of the presumption, an analysis in which they were joined by leading commentators, "invite[d the Court's] . . . reappraisal." After taking this fresh look, the Court was persuaded by the same considerations that had swayed everyone else—the indisputable fact that most patents convey no market power whatsoever, and the frequent use of tying by sellers that lack market power and hence have no ability to use the arrangements for anticompetitive purposes.

The Next Issue: Is Tying Still *Per Se* Illegal?

It is unclear how high the bar has been raised for plaintiffs in tying cases. In recent years, despite continuing use of the *per se* label, many courts have permitted defendants to prove a legitimate business justification for tying, effectively transforming ostensibly *per se* treatment into a rebuttable presumption of anticompetitive effects. The propriety of this approach was not presented in *Independent Ink* and the Court's signals are ambiguous.

The Court expressly directed that this and future cases involving a patented tying good be decided according to the "standards applied" in two of its historical tying cases involving unpatented goods, *Fortner II* and *Jefferson Parish*. Both of these cases adopt the view that if a plaintiff establishes that the seller has power in the tying product, it need not also prove that the tying arrangement is actually anticompetitive. Indeed, *Jefferson Parish* contains an extensive justification of this approach. This is *per se* treatment, and it has traditionally been so labeled.

Nevertheless, the Court appeared to studiously avoid using the term "*per se*" in connection with anticompetitive effects. And given the opinion's sympathetic language about tying generally ("[m]any tying arrangements . . . are fully consistent with a free, competitive market"), *Independent Ink* may lay the groundwork for full rule-of-reason treatment of tying, with no *per se* treatment or even presumption of anticompetitive effects.

The *Dagher* Decision

"The pricing decisions of a legitimate joint venture do not fall within the narrow category of activity that is *per se* unlawful under §1 of the Sherman Act."

Like *Independent Ink, Dagher* appeared to present only a narrow issue: the application of the *per se* rule to the pricing of a joint venture. But in reaching the widely expected result that the *per se* rule did not apply, the Court made significant holdings regarding the nature of a legitimate joint venture and also signaled the continued erosion of *per se* rules of illegality.

Texaco and Shell historically have competed with each other in the exploration and production of crude oil, as well as in the "downstream" markets for refining, transporting, and selling petroleum products to customers. In 1998, Texaco and Shell formed a joint venture called "Equilon," to which each company contributed its downstream operations and assets in the western United States. Under the joint venture agreement, Texaco and Shell agreed to share the risks and profits associated with Equilon's activities, thereby

ending competition between the two companies for the refining and marketing of gasoline in the western United States.

The formation of Equilon was investigated by the Federal Trade Commission and four western state attorneys general for possible violation of the antitrust laws. The FTC initially issued a complaint alleging that the combination of these businesses (as originally proposed) would violate Section 7 of the Clayton Act, which prohibits mergers and other business combinations where the result may be a substantial lessening of competition. As a result of the government's concerns, Texaco and Shell entered into a consent agreement requiring modifications to the original Equilon agreement, including divestiture of certain assets. The parties were then allowed to move forward with the Equilon joint venture, and the companies ceased operating as independent competitors in the downstream markets.

The Equilon joint venture sold both Texaco-branded and Shell-branded gasoline to customers. At some point, Equilon decided to adopt the pricing strategy of charging the same price for both brands. In reaction to this decision, a group of Texaco and Shell service station operators brought suit alleging that Texaco and Shell had violated the *per se* rule against price fixing among competitors under Section 1 of the Sherman Act.

Lower Courts Divided on *Dagher*

At trial, the District Court granted summary judgment for Texaco and Shell, ruling that the *per se* standard for price fixing among competitors was not applicable to the pricing decisions of a legitimate joint venture. The court reasoned that every joint venture must, at some point, set prices for the products it sells, and applying a *per se* rule to those decisions would effectively prohibit joint ventures between companies that produce competing products.

On appeal, the Ninth Circuit reversed, holding that the *per se* rule against price fixing did apply to the joint venture's decision to unify the prices of its two distinct product brands. The Ninth Circuit went on to apply the "ancillary restraints" doctrine, holding that Shell and Texaco could avoid *per se* condemnation of the challenged pricing decision only by demonstrating that it was "ancillary" and reasonably necessary to further the legitimate aims of the joint venture. The court determined that the decision to unify the pricing of the Texaco-branded and Shell-branded gasoline was not ancillary and not reasonably necessary to further the legitimate aims of the joint venture, and concluded that the pricing decision was therefore a *per se* illegal agreement on price.

Pricing by a Legitimate Joint Venture Does Not Constitute *Per Se* Illegal Price Fixing

In an 8-0 opinion authored by Justice Thomas, the Court held that neither the *per se* rule nor the ancillary restraints doctrine applies to Equilon's conduct in making its pricing decision. Because the service station owners had not challenged the legality of the joint venture itself, the Court reversed the judgment of the court of appeals.

The joint venture was properly analyzed as a single firm

Even though Equilon continued to market both Texaco-branded and Shell-branded gasoline, the Court ruled that competition between Texaco and Shell effectively ended when the companies formed their joint venture. Through the joint venture, "Texaco and Shell Oil did not compete with one another in the relevant market—namely, the sale of gasoline to service stations in the western United States—but instead participated in that market jointly through their investment in Equilon." The Court found that the pricing decision amounted "to little more than price setting by a single entity" and not a pricing agreement between competitors in the market. As such, the *per se* rule against price fixing among competitors was inapplicable.

The joint venture was not a sham

In ruling that Equilon's pricing decisions amounted to single-firm conduct (as opposed to merely an agreement among competitors), the Court noted that there was no evidence in the record to suggest that the joint venture was itself illegitimate or lacked a pro-competitive business justification, and the service station owners made no such allegation under a rule of reason analysis. To the contrary, the Court noted the "voluminous record" documenting the joint venture's pro-competitive business justifications. In addition, the joint venture had been fully investigated by the FTC and state regulators, and modifications to the original agreement had been secured to allay any antitrust concerns.

Significant to the Court's determination that Equilon was presumptively a legitimate and lawful joint venture was the fact that Texaco and Shell had pooled their respective resources in forming the venture, and

shared in the profits or losses from the venture's activities. The Court reasoned that where two otherwise competing firms form a venture to "pool their capital and share the risks of loss as well as the opportunities for profit," such ventures are properly regarded as a "single firm competing with other sellers in the market" for purposes of the antitrust laws.

In so doing, Justice Thomas appears to have articulated a rather inclusive standard for determining legitimate competitor joint ventures. By contrast, the federal enforcement agencies have gone to great lengths to be more restrictive, requiring "an efficiency-enhancing integration of economic activity" and that agreements restricting the parents of the joint venture be "reasonably related to the integration and reasonably necessary to achieve its procompetitive benefits." *See, e.g.,* Antitrust Guidelines for Collaborations Among Competitors §§ 2.1, 3.3.

Pricing of JV products is a core activity not subject to the ancillary restraints doctrine

The Court rejected the Ninth Circuit's application of the ancillary restraints doctrine because that analysis governs the validity of restrictions imposed by a legitimate joint venture on *non-venture* activities. That analysis is used to determine whether such a restriction is an unnecessary (or "naked") restraint on trade (and thus invalid) or is reasonably ancillary to the legitimate and competitive purpose of the business relationship (and thus valid).

The Ninth Circuit should not have applied an ancillary restraints analysis in this case because the conduct at issue did not involve a restraint on a non-venture activity, but rather implicated a "core" activity of the joint venture. The Supreme Court stated that "the ancillary restraints doctrine has no application here, where the business practice being challenged involves the core activity of the joint venture itself—namely, the pricing of the very goods produced and sold by Equilon."

While there can be little doubt that pricing the products it sells will constitute a "core" function of a joint venture, the opinion provides little guidance to help distinguish between "core" and "non-venture" activity. This distinction is critical in determining when a joint venture may need to defend the reasonableness of its conduct in light of its legitimate business purposes.

Implications for Other Outdated Antitrust Precedent

One message from the *Independent Ink* decision is that the Court remains willing to reconsider and overrule outmoded antitrust precedent. One practice for which this may have ramifications is minimum resale price maintenance, still categorized by surviving precedent—without any principled basis—as *per se* illegal. In *Dagher,* the Court, in a parenthetical, summarized *State Oil v. Khan* as establishing the proposition that "vertical price-fixing arrangements are subject to the rule of reason, not *per se* liability."

In fact, *Khan* held only that *maximum* resale price maintenance should be subject to a rule of reason analysis, and did not change the standard of review associated with *minimum* resale price maintenance. While it is possible that the description of the *Khan* holding in the *Dagher* opinion was simply in error, it may also provide a glimpse into the Court's views relating to any future minimum resale price maintenance cases.

The pace of modernization, however, is likely to be glacial. Notably, while overruling its older precedent in this case, the Court said nothing to encourage any lower court to modernize Supreme Court antitrust precedent on its own, no matter how extensive the criticism of an outmoded decision or how unjust the result of blindly applying precedent. Rather, the Court expressed its willingness to take up cases where a no-longer-supportable precedential decision appears to dictate an incorrect result.

But the relevant issues become eligible for Supreme Court review very infrequently. For example, the congressional revisions to the patent misuse statute on which the Court based much of its *Independent Ink* decision were enacted in 1988; it has taken nearly two decades for the Supreme Court to harmonize antitrust law accordingly.

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