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U.S. Supreme Court Rules That a Joint Venture's Setting of Prices for Its Own Products Is Not an Antitrust Violation

In *Texaco Inc. v. Dagher*, a unanimous ruling with potentially wide-ranging implications for the pricing and other core activities of joint ventures, the U.S. Supreme Court has reversed a decision of the Ninth Circuit Court of Appeals and held that it is not *per se* illegal under the anti-collusion provision of the Sherman Act, 15 U.S.C. §1, for a lawful joint venture to set the prices at which it sells its products.[1] The Court stated that "As a single entity, a joint venture, like any other firm, must have the discretion to determine the prices of the products that it sells, including the discretion to sell a product under two different brands at a single, unified price."

The Court's opinion insulates the pricing policies of lawful joint ventures from *per se* and "quick-look" antitrust liability. The opinion does not insulate those or other competitive decisions from challenge under the rule of reason, in which market structure, concentration and performance are analyzed in order to predict the effects of the joint venture's conduct. However, we believe that the necessary implication of *Dagher* is to protect a joint venture's unilateral pricing and marketing decisions from antitrust challenge as an unreasonable restraint of trade unless the joint venture itself is challenged under the antitrust laws.[2]

Background: Texaco and Shell Integrated Their Refining and Marketing Operations in Certain Markets, and the Joint Ventures Decided to Price the Brands Identically

Texaco Inc. and Shell Oil Co. formed Equilon, a joint venture into which they merged their petroleum refining and marketing operations in the midwestern and western United States and all their petroleum pipeline interests in the United States. A second joint venture among Texaco, Shell and Saudi Refining Co. ("SRC"), consolidated those companies' refining and marketing operations in the Gulf Coast and eastern United States, including an existing joint venture between Texaco and SRC. The boards of directors of the joint ventures consist of designees, including employees, of the respective joint venture participants.

Texaco and Shell retained ownership of their trademarks and control over their brands and marketing strategy, but gave the joint ventures exclusive licenses to sell Shell-branded and Texaco-branded gasoline in their respective geographic regions and prohibited the joint ventures from giving preferential treatment to either brand. Texaco and Shell agreed not to compete with either of the ventures. The firms agreed to divide profits and losses from the joint ventures in a fixed ratio based on assets contributed to the ventures. The Federal Trade Commission investigated the parallel transactions as mergers of competing businesses, and entered a consent order requiring divestiture of various assets to remedy antitrust concerns.[3]

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[1] *Texaco Inc. v. Dagher*, ___ U.S. ___, 2006 U.S. Lexis 2023, reversing *Dagher v. Saudi Refining, Inc.*, 369 F.3d 1108 (9th Cir. 2004). Justice Thomas wrote the February 28, 2006 opinion; Justice Alito did not participate.

[2] Nothing in the decision protects a joint venture's conduct from challenge under the anti-monopolization provision, Section 2 of the Sherman Act, or under other antitrust and trade regulation statutes such as the Robinson-Patman Act, just as the conduct of any firm can be challenged under those statutes.

[3] *In re Shell Oil Company*, 125 F.T.C. 769 (1998).

Around the time of the formation of the joint ventures, "a decision was made" that the ventures would sell Texaco and Shell brands at the same price in the same market areas, and a single person at each joint venture was designated to set a coordinated price for the two brands.[4]

The Decisions Below: Competing Standards of Review

A class of Texaco and Shell service station owners brought suit in the United States District Court for the Central District of California, alleging that by setting common gasoline prices for the two brands, Texaco and Shell had violated the long-recognized *per se* rule against price fixing under Section 1 of the Sherman Act. The district court awarded summary judgment to Texaco and Shell, deciding that the rule of reason, rather than a *per se* rule or the "quick-look" doctrine, governed the claim. The court then noted that the class plaintiffs had declined to pursue a rule-of-reason analysis and held that they had failed to raise a triable issue of fact.

The Ninth Circuit reversed, rejecting what it characterized as Shell's and Texaco's requests for an "exception to the *per se* prohibition on price fixing." The Ninth Circuit also decided that the ventures' conduct should be reviewed as an "ancillary restraint" to the formation of the ventures, which requires that the defendants show that the agreement is reasonably necessary to the legitimate and competitive purposes of the venture. The Supreme Court consolidated Texaco's and Shell's separate petitions and granted certiorari to determine whether the *per se* rule against price fixing applies to what the Court recognized as "an important and increasingly popular form of business organization, the joint venture."

The Supreme Court's Opinion: No Per Se Liability for Pricing by a Single Entity

A mere seven weeks after oral argument, which included an appearance by the United States as *amicus curiae*,[5] the Court issued a very straightforward six-page decision, rejecting the plaintiffs' argument that the pricing decisions of the joint ventures violated the *per se* prohibition against price fixing. The Court stated the common rule that *per se* treatment should be applied only to conduct that is "plainly anticompetitive", such as horizontal price-fixing agreements between competitors. The joint venture agreements were not these typical horizontal price-fixing arrangements because Texaco and Shell were not competitors in the relevant markets of gasoline sales to service stations. Instead, Texaco and Shell jointly participated in those markets through the joint ventures, whose formation had been approved by federal and state regulators, and which were not challenged by the plaintiffs.

Thus, the Court held that the activities under review did not fall into the category of agreements that are *per se* unlawful, because they were the acts of a "single entity". Texaco and Shell were investors in the joint ventures, and therefore the joint ventures' decisions to price both brands of gasoline at the same prices were "not a pricing agreement between competing entities with respect to their competing products" and "not price fixing in the antitrust sense."

The Supreme Court did not address whether the joint ventures' pricing should be reviewed under the rule of reason because the plaintiffs did not allege that the pricing decisions were illegal on that basis. "If Equilon's price unification policy is anticompetitive, then respondents should have challenged it pursuant to the rule of reason." (We discuss in the "Comment" whether this suggestion is useful to plaintiffs.) The Court also rejected the plaintiffs' argument that it should apply the "quick-look" doctrine, holding that the business activities under review were not so plainly anticompetitive as to justify only cursory examination before imposing antitrust liability.

The Court strongly rejected the Ninth Circuit's reliance on the ancillary restraints doctrine, which governs the validity of restrictions imposed by a legitimate business collaboration on "non-venture" conduct. Under that doctrine, if a restriction is a naked restraint on trade, it is invalid; by contrast, if it is ancillary to the legitimate and competitive purposes of the collaboration, it is valid. The Court made clear the doctrine is inapplicable to business practices that "involve[] the core activity of the joint venture itself," and cited approvingly the dissent in the Ninth Circuit to the effect that in any event pricing policies are inherently ancillary to the sale of a firm's own products: "What could be more integral to the running of a business than setting a price for its goods and services?"[6]

Comment: Is There Any Room for the Application of Sherman Act Section One to the Unilateral Competitive Decisions of Joint Ventures?

The Court's emphasis on the nature of the joint venture as a single entity leaves little doubt that the Court would treat all unilateral marketing decisions by the joint venture involving its own products as it has treated pricing. For example, a

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4 *Dagher v. Saudi Refining, Inc.*, 369 F.3d at 1112.

5 The Department of Justice, together with the Federal Trade Commission, urged both the result and the analysis reached by the Court and argued that, by threatening efficiency-enhancing joint ventures with *per se* liability, the Ninth Circuit's result was inconsistent with the pro-competitive purposes of the antitrust laws.

6 369 F.3d at 1127.

decision by the joint venture to sell only Texaco gasoline in one region and only Shell gasoline in another region, or to market Texaco gasoline to retailers of a certain size and Shell gasoline to retailers of a different size, should not be treated as a *per se* illegal allocation of markets or agreement not to compete for each brand's customers.

The most interesting implication of *Dagher* is whether any unilateral competitive decision by a lawful joint venture concerning its own products could be challenged under the rule of reason. Defendants asked the Court to declare that Section 1 of the Sherman Act is simply inapplicable to joint ventures, but the Court found it unnecessary to address that argument. The Court's repeated and unequivocal reference to the joint venture as a "single entity" suggests that the only rule of reason challenge open to plaintiffs would be one to the creation of the joint venture itself. Under the rule of *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984), the unilateral conduct of a single entity is simply not subject to challenge under Section 1, because a single entity cannot agree with itself. Thus, it appears that future plaintiffs would need to challenge the lawfulness of a joint venture as a whole, showing either that the venture is a sham, that it is not economically integrated, or that its creation unduly concentrates the markets in which it operates, in order to obtain a decision that any unilateral conduct by that venture is an unreasonable restraint of trade under Section 1 of the Sherman Act.

Alternatively, if the challenged business practice did not involve a "core activity" of the joint venture, plaintiffs apparently can continue to rely on the ancillary restraints doctrine, *i.e.*, to argue that the challenged practice is not reasonably ancillary and therefore is an illegal naked restraint of trade. However, this avenue may not add much to plaintiffs' potential theories, because a business practice that does not involve a core activity of the joint venture may well involve a separate party, *i.e.*, the parents' activities outside the joint venture, thus giving rise to an agreement for purposes of a Section 1 challenge.

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