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BRIEFING

Supreme Court upholds joint venture pricing decision

Summary

This briefing looks at the important aspects of the recent Supreme Court ruling in *Texaco v. Dagher*, which examined the validity of a joint venture's pricing decision.

The Supreme Court recently ruled that a fully integrated, legitimate joint venture does not engage in per se unlawful price fixing when it sets the price of its products.

In a brief, unanimous decision (with Justice Alito not participating), the Court in *Texaco v. Dagher*, 547 U.S. __ (2006) cemented the limited boundaries of the per se doctrine further, ruling it inapplicable to a joint venture's activities because a joint venture is a single economic entity. This ruling was widely expected and is uncontroversial given current jurisprudence. The judgment's treatment of the ancillary restraints doctrine, though, raises some issues, as discussed in more detail below.

The underlying case seemed uncontroversial and its facts show why for the most part a straightforward, unanimous opinion was issued by the Court. Texaco and Shell formed a joint venture called Equilon (combining their refining and marketing operations in the western U.S. while their eastern refining and marketing operations were combined in another joint venture, Motiva, that also included Saudi Refining), although they continued to compete in other areas such as the exploration and production of crude oil. Texaco and Shell awarded Equilon exclusive licenses to sell their individual brands of gasoline and established a profit sharing agreement to distribute the profits from such sales. The joint venture agreement had been notified to the federal antitrust agencies, which had approved it, along with several state attorneys general, after imposing some undertakings.

Although each brand of gasoline retained its distinct formulation, it was decided that the joint venture would set a common price at which it would sell both brands of gasoline. The case originated when a class of gasoline service station owners sued Texaco and Shell, alleging the two companies had engaged in a per se illegal price-fixing agreement when through their joint venture a common price was set for their separate brands of gasoline. The plaintiffs argued that setting a joint price for the two brands of gasoline to be sold by Equilon was not necessary to the venture's legitimate goal of creating cost efficiencies and therefore constituted a per se illegal violation of the antitrust laws.

Per se agreements are considered naked restraints, illegal regardless of their proffered justification or actual competitive effect. The per se classification generally is reserved for conspiracies between two or more horizontal competitors. Ruling that a joint venture's decision to set the price at which it sells its products did not constitute a per se violation – the only claim asserted by the plaintiffs – the district court granted Texaco's and Shell's summary judgment motion.

Before the Supreme Court, Texaco and Shell argued the district court decision should be upheld because a legitimate, fully-integrated joint venture could not engage in per se unlawful price fixing because a joint venture is a single economic entity, incapable of engaging in the type of horizontal price fixing activity for which per se condemnation is reserved. Filing an amicus brief, the U.S. Department of Justice and Federal Trade Commission supported Texaco's and Shell's position.

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The Supreme Court agreed, ruling that per se liability should be applied narrowly, only to activity that is so plainly anticompetitive – such as agreements among horizontal competitors affecting price – that no elaborate study is needed. In this case, the Court ruled that Texaco and Shell did not engage in the type of activity justifying per se treatment because the joint venture was a single economic entity incapable of conspiring with itself. The Court noted that when two competitors pool their capital and share the risk of loss they engage in literal price fixing but "not price fixing in the antitrust sense".

In addition to this core ruling, the Court also addressed the ancillary restraints doctrine that the Ninth Circuit had relied upon to reverse the district court decision in favor of Texaco and Shell. Under the ancillary restraints doctrine, restraints on competition imposed in a joint venture must be reasonably necessary to the venture's legitimate goals. If so, the validity of the restriction is judged under the less strict rule of reason rather than the per se standard. The plaintiffs in this case argued that setting a joint price for both brands of gasoline was unnecessary to the legitimate cost efficiency seeking goals of joint venture and therefore such conduct could be challenged under the per se rule. The plaintiffs in fact eschewed a rule of reason claim, presumably because existing competition in the gasoline refining and marketing industry made such a claim implausible.

The Ninth Circuit had reversed the district court decision because in its view Texaco and Shell were seeking an exemption to the per se rule against horizontal price fixing even though they continued to sell their formerly competitive products as distinct brands just because they combined their refining and marketing functions in a joint venture. Invoking the ancillary restraints doctrine advocated by the plaintiffs, the Ninth Circuit concluded that the agreement to unify prices was a naked restraint as there was no suggestion that it was reasonably necessary to the legitimate cost efficiency aims of the joint venture.

However, the Supreme Court stated that the ancillary restraints doctrine was inapplicable as it applied only to the non-venture activities of the joint venture partners, not to such core activity as the determination of the price at which a joint venture sells its products. That position seems to contradict the requirement that restrictions imposed within the joint venture itself must be reasonable and potentially leaves a gap in the analytical framework for considering such restraints.

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